AGRICULTURAL CREDIT CONDITIONS

HEARINGS

BEFORE THE

SUBCOMMITTEE ON CONSERVATION, CREDIT,
AND RURAL DEVELOPMENT

OF THE

COMMITTEE ON AGRICULTURE
HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

FIRST SESSION

SEPTEMBER 11, AND 12, 1985;
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AGRICULTURAL CREDIT CONDITIONS

WEDNESDAY, SEPTEMBER 11, 1985

House of Representatives,
Subcommittee on Conservation, Credit,
and Rural Development,
Committee on Agriculture,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:10 a.m., in room 1302, Longworth House Office Building, Hon. Ed Jones of Tennessee (chairman of the subcommittee) presiding.

Present: Representatives Weaver, Glickman, Daschle, Stenholm, Tallon, Evans of Illinois, Thomas, Stallings, Coleman, Morrison, Gunderson, Evans of Iowa, and Franklin.

Also present: Representative E (Kika) de la Garza, chairman of the committee, and Representative Combest, member of the committee.

Staff present: Glenda L. Temple and Francie Monaghan, clerks; Robert A. Cashdollar, James W. Johnson, Jr., Fred Clark, Bernard Brenner, James Davis, Susan Adkins, and Carol Ann Dubard.

OPENING STATEMENT OF HON. ED JONES, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE

Mr. Jones of Tennessee. Good morning.

The Subcommittee on Conservation, Credit, and Rural Development will come to order.

We welcome all visitors who are here as well as witnesses today.

Today we begin the first day of a series of hearings on agricultural credit, problems that are nationwide with a special look at problems in the cooperative Farm Credit System and with other farm lenders.

Today and tomorrow we will be hearing primarily from elected officials, from agricultural-related organizations, from farmers, and interested officials of PCA's and Federal Land Bank Associations.

Then around October 1, we will have another session to hear from the Farm Credit Administration, officials of the Farm Credit System, major commercial bankers associations, and others that I'll not mention this morning.

I am particularly interested today and tomorrow to hear our witnesses because next week we may be meeting with the farm credit banks and boards of directors. That will depend, of course, upon whether or not the farm bill comes to the floor of the House in the early part of next week. My intention is to report to them what I learn at these hearings in case I am able to go.

As you can see, we have a full agenda for today. This morning's session will be devoted to Members of the House and Senate. I would ask each witness to summarize their remarks in 5 to 10 minutes, if at all possible. If you summarize, your entire written statement will be entered in the record.

Before we hear the first witness, I would like to first recognize the chairman of the full Committee on Agriculture, and then to hear from the subcommittee members as they are here this morning.

At this time I would like to recognize Mr. de la Garza.

OPENING STATEMENT OF HON. E (KIKA) de la GARZA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

The CHAIRMAN. Thank you very much, Mr. Chairman.

Mr. Chairman, you and Mr. Coleman, the ranking minority member, and all of the members of the subcommittee have a vital but very complex problem. We know the history of the Farm Credit System, and we know of its good work and all of the antecedents that have brought us to this point. The question now is: What role should Congress play?

The first necessary step must be passage of a general farm bill that goes as far as possible toward protecting farm income against further blows. We are already well along in that. As you know, we passed out of committee an approved general farm bill last night.

The next step, Mr. Chairman, begins in this subcommittee. I hope the subcommittee will begin by documenting the nature of the problem facing the Farm Credit System. Of course, it is obvious that the system is in trouble because farm income is low.

I had an interview with one of the network television people, and they wanted a complex, long, drawn-out definition.

They had a series of questions. They said: "Can you sum it up?"

I said, "Yes. You have a lender and you have a borrower. The borrower doesn't have the money to pay the loan back, period." That's what happened.

But now I think that we need to see if within existing authorities the Farm Credit System can help—also, if there is need for change in the system or in the powers that we have given in the charter to the Farm Credit System. Once we go beyond what they can do themselves with existing authority or if they need additional authority, then do we provide them with necessary financing?

Too loosely, the word "bailout" has been bandied around. This is not a bailout. It is not an attempt at a bailout, but rather a question of whether we have to give additional seed money. I would insist that it has to be of the type that it was in the beginning—that is, paid back as the system gets back on its feet, so that there will be no taxpayers' money given to anyone for whatever reason the situation arose.

I would hope that the subcommittee, and eventually the committee, takes this into consideration. The bottom line is we cannot let the system fail, but do we need to expand the authority or require them to have reserves of larger proportion, sharing of larger proportion? Do we need more guidance from the central system to the banks or down the line? Eventually, Mr. Chairman, do we need maybe an FDIC-type operation supported by them, as they do in the private sector?

I thank you, Mr. Chairman, and your subcommittee. I would challenge you to establish beyond a doubt the congressional need at the end so that we might address it properly. We cannot let it fail. It comes at a very critical time for many other reasons, but the bottom line is what caused it. The farmer who borrowed didn't have the money to pay back. Now we're not going to be able to solve that unless we provide income for the farmer. That is in another area.

I would hope that we will have further hearings to properly document what we must do.

I wish you well, Mr. Chairman.

[The prepared statement of Mr. de la Garza follows:]

STATEMENT BY HON. E (KIKA) DE LA GARZA, TEX.
CHAIRMAN, HOUSE AGRICULTURE COMMITTEE
TO THE SUBCOMMITTEE ON CONSERVATION, CREDIT & RURAL DEVELOPMENT
SEPT. 11, 1984

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE,

I WANT TO THANK CHAIRMAN JONES FOR SCHEDULING THIS HEARING TO BEGIN THE VERY IMPORTANT JOB OF FINDING OUT WHAT PART THE CONGRESS CAN RESPONSIBLY PLAY IN HELPING TO SOLVE THE FARM CREDIT PROBLEMS WE ARE GOING TO FACE ... AND IN PARTICULAR, THE PROBLEMS FACING THE COOPERATIVE FARM CREDIT SYSTEM.

MR. CHAIRMAN, YOU AND MR. COLEMAN, THE RANKING MINORITY MEMBER, AND ALL OF THE MEMBERS OF YOUR SUBCOMMITTEE, HAVE A VITAL BUT VERY COMPLEX PROBLEM. I BELIEVE THE SITUATION WAS SUMMED UP IN A NEWS STORY RECENTLY WHICH BEGAN: "THE FARM CREDIT SYSTEM, THE USA'S LARGEST FARM CREDITOR, IS FACING ITS MOST SEVERE CRISIS SINCE THE GREAT DEPRESSION, THE SYSTEM'S TOP REGULATOR SAID THURSDAY."

THE FARM CREDIT SYSTEM, AS WE KNOW IT TODAY, IS ONE OF THE MOST IMPORTANT PARTS OF AMERICAN AGRICULTURE. IT IS A PRIVATE SYSTEM, OWNED BY ITS FARMER-BORROWERS, WHICH FURNISHES ABOUT ONE-THIRD OF THE CREDIT USED BY AGRICULTURAL PRODUCERS. BECAUSE THERE IS SOMETIMES A LITTLE CONFUSION ABOUT JUST WHAT THE FARM CREDIT SYSTEM IS ... AND WHAT ITS RELATION TO THE GOVERNMENT IS ... I WOULD LIKE TO PUT INTO THIS RECORD SOME VERY BRIEF HISTORY.

THE SYSTEM WE KNOW TODAY WAS BORN IN 1916 WHEN CONGRESS CREATED THE FEDERAL LAND BANKS AND EXPANDED IN TWO LATER STEPS. IN 1923, CONGRESS CREATED THE FEDERAL INTERMEDIATE CREDIT BANKS AND THEIR PRODUCTION CREDIT ASSOCIATION, AND IN 1933 WE ADDED THE BANKS FOR COOPERATIVES TO PROVIDE CREDIT FOR CO-OPS. ALL OF THESE INSTITUTIONS WERE BORN WITH THE HELP OF FEDERAL SEED MONEY ... PURCHASES OF STOCK BY THE FEDERAL GOVERNMENT. OVER THE YEARS, HOWEVER, THE LAND BANKS, THE INTERMEDIATE CREDIT BANKS AND THE BANKS FOR COOPERATIVES PAID OFF THE FEDERAL STOCK. IN 1968, A FINAL PAYMENT OF $148 MILLION CLEARED OUT THE LAST OF THE FEDERAL INVESTMENT.

SINCE THAT DATE, THE ENTIRE FARM CREDIT SYSTEM HAS BEEN AA PRIVATE FINANCIAL INSTITUTION, TOTALLY OWNED BY ITS FARMER STOCKHOLDERS AND BORROWERS. THERE IS NO GOVERNMENT MONEY IN THE SYSTEM TODAY. THERE IS A FEDERAL AGENCY, THE FARM CREDIT ADMINISTRATION, WHICH ACTS AS A REGULATORY BODY FOR THE SYSTEM, BUT EVEN HERE ITS COSTS ARE MET BY FEES LEVIED ON THE FARMER-OWNED UNITS OF THE SYSTEM.

FOR MANY YEARS, MOST OF US HAVE REGARDED THE FARM CREDIT SYSTEM AS ONE OF THE GREAT SUCCESS STORIES OF AMERICAN AGRICULTURE AND THE NATIONAL ECONOMY. TODAY, HOWEVER, THE

GOVERNOR OF THE FARM CREDIT ADMINISTRATION HAS BEEN TELLING US AND THE PUBLIC THAT THE SYSTEM WILL NEED HELP IF THE FARM ECONOMY DOES NOT SHOW IMPROVEMENT SOON.

THE QUESTION NOW IS, WHAT ROLE SHOULD CONGRESS PLAY?

THE FIRST NECESSARY STEP MUST BE PASSAGE OF A GENERAL FARM BILL, THAT GOES AS FAR AS POSSIBLE TOWARD PROTECTING FARM INCOME AGAINST FURTHER BLOWS, AND WE ARE ALREADY WELL ALONG IN THAT PROCESS.

THE NEXT STEP BEGINS HERE AND NOW IN THIS SUBCOMMITTEE. I HOPE THE SUBCOMMITTEE WILL BEGIN BY DOCUMENTING THE NATURE OF THE PROBLEMS FACING THE FARM CREDIT SYSTEM. OF COURSE, IT IS OBVIOUS THAT THE SYSTEM IS IN TROUBLE BECAUSE FARM INCOME IS LOW ... BECAUSE SOME BORROWERS CAN'T PAY BACK THEIR LOANS ... AND BECAUSE DECLINING FARM LAND PRICES HAVE REDUCED THE VALUE OF THE SECURITY BEHIND MANY LOANS. BEYOND THAT, WE SHOULD FIND OUT JUST WHAT THE NEEDS OF THE SYSTEM ARE AND HOW THEY CAN BE DEALT WITH.

I WOULD LIKE TO KNOW, FOR EXAMPLE, WHAT CAN BE DONE BY ADMINISTRATIVE ACTIONS UNDER EXISTING LAW. IF THE SYSTEM CAN SOLVE ITS PROBLEMS WITH EXISTING AUTHORITIES, WE SHOULD KNOW THIS. WE SHOULD FIND OUT, ALSO, IF THERE IS A NEED FOR CHANGES IN FARM CREDIT SYSTEM PROCEDURES OR IN THE POWERS OF THE FARM CREDIT ADMINISTRATION WHICH REQUIRE NEW LEGISLATIVE AUTHORITY. AND FINALLY, AS A LAST STEP, WE WANT TO FIND OUT WHETHER FINANCIAL HELP OF SOME KIND IS NEEDED.

I AM NOT GOING TO PREJUDGE ANY OF THESE MATTERS. I WILL SAY THAT I BELIEVE THE FARM CREDIT SYSTEM IS SO IMPORTANT TO AMERICAN AGRICULTURE THAT CONGRESS WILL NOT WANT TO STAND BY AND WATCH IT OR LARGE SEGMENTS OF IT COLLAPSE. I DO NOT BELIEVE THAT THE SYSTEM WANTS OR SHOULD HAVE A "HANDOUT" OR A "BAILOUT" IN THE ORDINARY SENSE OF THAT TERM. BUT IF THE MATTERS OF OPERATING PROCEDURES AND SYSTEMS ARE DEALT WITH, I WOULD BE PREPARED TO CONSIDER -- IF THE NEED IS DOCUMENTED -- SOME FORM OF RENEWED FEDERAL INVESTMENT IN THE SYSTEM. I WOULD NOT REGARD THIS TYPE OF ACTION AS A BAILOUT. ANY ADVANCES WHICH MAY TURN OUT TO BE NEEDED COULD BE TREATED JUST LIKE THE ORIGINAL FEDERAL "SEED MONEY" CAPITAL, AND REPAID WHEN CONDITIONS IMPROVE JUST AS THE ORIGINAL CAPITAL WAS REPAID.

IN THE END, I BELIEVE THE BASIS OF THE FARM CREDIT PROBLEM IS THE DEPRESSED FARM ECONOMY. WE SHOULD KEEP THAT IN MIND AS WE LOOK AT THE SITUATION. AND I WANT TO REPEAT THAT, WHILE WE MUST WORK WITHIN A FEDERAL BUDGET SITUATION THAT AFFECTS EVERY PROGRAM WE DEAL WITH, I DO BELIEVE THAT IF ASSISTANCE IS NEEDED, WE SHOULD GIVE SERIOUS CONSIDERATION TO SOME FORM OF HELP AFTER CAREFULLY DOCUMENTING OTHER STEPS WHICH COULD BE TAKEN FIRST. THE BOTTOM LINE, MR. CHAIRMAN, IS THAT I DO NOT THINK WE CAN AFFORD A DISASTER IN THE FARM CREDIT SYSTEM.

Mr. JONES of Tennessee. I want you to know, Mr. Chairman, how much this subcommittee, and especially the chairman, appreciates your devotion and interest to this subcommittee's problems. We appreciate very much this very splendid opening statement that has been made by you.

Now with that statement, I'm going to defer to the ranking minority member of the subcommittee, Mr. Coleman, for any statement that he might want to make.

OPENING STATEMENT OF HON. E. THOMAS COLEMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MISSOURI

Mr. COLEMAN. Mr. Chairman, thank you very much.

First of all, let me say that I will have to leave the subcommittee this morning to go to a markup in the Education and Labor Committee. It's progressing right now.

I do want to make my statement and lend my support to these hearings, because I think it is very important that this subcommittee address the problem of farm credit. It is certainly not a new issue to this subcommittee. We have passed the Farm Credit Emergency Act earlier this session. However, it does appear to me that the financial situation of the Farm Credit System needs the immediate attention of this subcommittee, and I congratulate the chairman for calling these hearings.

Our financial problems within the Federal Farm Credit System are, indeed, staggering. The system alone holds 37 percent of the Nation's $212 billion farm and ranch debt and has as much as 15 percent of its $74 billion loans in nonperforming loans status.

Last fall, a full 12 months ago, I met with several officials of the Farm Credit Administration, the regulatory body of the Farm Credit System, in anticipation of this financial crisis within the Farm Credit System. For the past year, the Farm Credit Administration has ignored my warnings and others of an inevitable collapse, insisting that the system could work its way out of any problems as long as the agricultural situation did not deteriorate from its condition of 1 year ago.

Last week the Governor of the Farm Credit Administration made a statement which indicated the financial condition of the Farm Credit Systems had worsened to the extent that he is now asking for some Federal financial assistance, but I don't think the worsening of the farm situation is a surprise to any of us. I told the Governor things were going to get bad and they did. The only thing new today is that the head of the Farm Credit Administration has finally agreed with my assessment.

Unfortunately, he is 1 year too late, and the farmers have had to bear the costs of keeping the Farm Credit System solvent through higher interest rates at a time they are being literally kicked off their own land.

This travesty might have been avoided if the FCA hadn't waited until the 11th hour to recognize the degree of financial stress in the agricultural sector.

Since the Farm Credit System was created by Congress in the 1930's, it has always been proud of the fact that it was able to repay all of its Federal funds and maintain itself as a system that is owned entirely by its borrowers. But because of the unprecedented economic hard times in farm country, I believe it is now inevitable that Congress will be called upon to develop a Federal financial and regulatory assistance package to help the farm credit banks. I thought so a year ago and I think so today.

The structure of any type of assistance package developed by Congress will be of the utmost importance. It must be a plan to help not only the Farm Credit System, but also it must assure a steady and competitive—I underline the word "competitive"—line of credit to farmers.

Investors on Wall Street must be given confidence in the system, and the taxpayers must be assured that their money is being used wisely and prudently.

Several plans have been discussed in the most general of terms. I hope to see a consensus develop between the Farm Credit Administration, the Farm Credit System, the Department of Agriculture, the White House, and, yes, this subcommittee.

I must warn the subcommittee to act cautiously when crafting an assistance package, so that the Agriculture Committee maintains control over the legislative process. The Farm Credit System is a very complicated system. The Agriculture Committee has a unique understanding of the system and the agricultural economy that it serves. If we get into banking issues, we will split the committee jurisdiction between our Agriculture Committee and the Banking Committee and create many difficulties as well as slowing up the entire process.

Last week I met with Frank Naylor, the Under Secretary of Agriculture, and Marvin Duncan, the Senior Deputy Governor of the Farm Credit Administration in separate meetings to discuss the problems facing the Farm Credit System. I personally was encouraged to see that there is more of a consensus for an agreement between the administration and the Farm Credit Administration than the public has been led to believe by press reports. Both Mr. Naylor and Mr. Duncan seemed closer to an understanding that the Farm Credit System would have to tap some of its reserves, possibly up to $4 billion, before the administration or Congress could commit Federal funds. I think that the FCA is realizing that Congress will only be willing to help if the system first takes steps to help itself.

I was further encouraged by the recent actions and steps taken by the Federal Farm Credit Board last week to relieve the financial burdens of the ailing farm credit banks. These steps include giving the Farm Credit Administration officials the authority to order money shifted from anywhere in the system to aid individual banks in trouble, and to shift money within 1 of the system's 12 regions to trouble spots within the region.

Mr. Chairman, in closing, the Farm Credit System is the single largest agricultural lender. If steps are not taken to put its finances back in order, we are going to witness the biggest financial fallout since the Great Depression. I predict it will make the Continental Illinois bailout look like a piggy-bank operation. I am hopeful a solution can be provided that will serve farmers, investors, and the taxpayers.

I agree with you, Mr. Chairman, that even though the Farm Credit Administration and the Farm Credit Systems are not prepared to testify today, we want them before this subcommittee and I would like to encourage each of them to develop a proposal that will restore confidence to the system. We hope that we will be able to have them before our subcommittee before the month is out for their testimony and recommendations.

We certainly look forward to the testimony from our colleagues and other witnesses today, but I think we all recognize that the important information and the strategy and the development of a financial assistance package is going to have to be developed with various parties and a very important party is the Farm Credit Administration. I look forward to those hearings later on this month.

Again, thank you, Mr. Chairman, for your cooperation between the two of us personally and for having these hearings at this very important time.

[The prepared statement of Mr. Coleman follows:]

PREPARED STATEMENT OF HON. E. THOMAS COLEMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MISSOURI

Mr. Chairman, I am pleased to see this Subcommittee addressing the problems of farm credit. It is certainly not a new issue to us as we already passed one emergency farm credit bill earlier in this session. However, it appears that the financial situation of the farm credit system needs the immediate attention of this subcommittee.

The financial problems within the Federal Farm Credit System are staggering. The system alone holds 37 percent of the nation's $212 billion farm and ranch debt and has as much as 15 percent of its $74 billion loans in non-performing loans.

Last fall I met with several officials with the Farm Credit Administration, the regulatory body of the farm credit system, in anticipation of this financial crisis within the farm credit systems. But for the past year, the Farm Credit Administration has ignored my warnings of an inevitable collapse, insisting the system could work its way out of any problems as long as the agricultural situation did not deteriorate from its condition one ~~year ago.~~

Last week the Governor of the Farm Credit Administration made a statement which indicated the financial condition of the farm credit systems has worsened to the extent that he is asking for some federal financial assistance. Well, I don't think the worsening of the farm situation is a surprise to any of us. I told the Governor things were going to get bad and they did. The only thing new today is that the head of the FCA has finally agreed with my assessment. Unfortunately he is one year too late and the farmers have had to bear the costs of keeping the farm credit system solvent through higher interest rates at a time they're being kicked off the land. This travesty might have been avoided if the FCA hadn't waited until the eleventh hour to recognize the degree of financial stress in the agricultural sector.

Since the farm credit system was created by Congress in the 1930's, it has always been proud of the fact that it was able to repay all federal funds and maintain itself as a system that is owned entirely by its borrowers. But because of the unprecedented economic hard times in farm country, I believe it is now inevitable that Congress will be called upon to develop a federal financial and regulatory assistance package to help the farm credit banks. I thought so a year ago and I think so today.

The structure of any type of assistance package developed by Congress will be of the utmost importance. It must be a plan to help not only the farm credit systems, but it must also assure a steady and competitive line of credit to farmers. Investors on Wall Street must be given confidence in the system and tax payers must be assured that their money is being used wisely and prudently.

Several plans have been been discussed in the most general terms. I hope to see a consensus develop between the Farm Credit Administration, Farm Credit System, the Department of Agriculture, the White House and this subcommittee.

I must warn this subcommittee to act cautiously when crafting an assistance package so that the Agriculture Committee maintains control over the legislative process. The farm credit system is a very complicated system. The Agriculture Committee has a unique understanding of the system and the agriculture economy that it serves. If we get into banking issues, we will split the committee juirisdiction and create many difficulties as well as slowing up the process.

Last week I met with Frank Naylor, Undersecretary of Agriculture, and Marvin Duncan, Deputy Governor of the Farm Credit Administration to discuss the problems facing the farm credit system. I was encouraged to see there is more of consensus for an agreement between the Reagan administration and the FCA than the public has been lead to believe by the press. Both Mr. Naylor and Mr. Duncan seemed closer to an understanding that the FCS would have to tap some of its reserves, possibly up to $4 billion, before the Administration or Congress could commit federal funds. I think the FCA is realizing that Congress will only be willing to help if the system first takes steps to help itself.

I was further encouraged by the recent steps taken by the Federal Farm Credit Board to relieve the financial burdens of the ailing farm credit banks. These steps include giving credit administration officials the authority to order money shifted from anywhere in the system to aid individual banks in trouble, and to shift money within one of the system's 12 regions to trouble spots within the region.

The Farm Credit System is the largest single agricultural lender. If steps are not taken to put its finances back in order, we are going to witness the biggest financial fallout since the Great Depression. It will make the Continental Illinois bailout look like a piggy-bank operation. I am hopeful a solution can be provided that will serve farmers, investors and the taxpayers.

I recognize that the Farm Credit Administration and the Farm Credit Systems are not prepared to testify today, but I would like to encourage each of them to develop a proposal that will restore confidence to the system. This subcommittee looks forward to hearing testimony and recommendations at hearings to be scheduled later in the month.

Mr. JONES of Tennessee. Thank you very much, Mr. Coleman, for a very splendid statement. I appreciate your cooperation, as I have told you many times. I know that we will have it throughout this session.

Now to Mr. Dan Glickman, a member of the subcommittee, for a statement.

OPENING STATEMENT OF HON. DAN GLICKMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF KANSAS

Mr. GLICKMAN. Thank you, Mr. Chairman.

I think that there are certain basic themes that we have to establish here, particularly as we hear from the parties themselves, the Farm Credit System and the Farm Credit Administration.

One of the things I think we have to ask is: Why did this all happen and why did it happen so fast, particularly after what I consider to be a whitewashing of the conditions within the Farm Credit System for so long? Not too long ago, in 1980, the Farm Credit System came to us and asked for us to expand their authorities, which we did. Over the last few years there have been many questions about the management of the system, the Farm Credit System itself.

Now I have no doubt that the problem is severe and serious, but I think one of the things we have to figure out is, why did it happen and why did it happen so quickly, and why was the Farm Credit System in this country so tardy, so involved in delay in bringing this problem to us, when we began to hear it from PCA's and Federal land bank officials back in our States a long time ago? Why did it take so long for this so-called crisis atmosphere to percolate to the top in the Farm Credit System and then come to the attention of Congress?

Now we all know why the Farm Credit System is really in trouble. It is in trouble because of low farm prices and a rapid decline in farmland values. One thing we have to remember is any bailout of the Farm Credit System, any injection of funds, any loan guarantees, any agricultural credit corporations will go for naught unless farm income goes up. We will be back here again and again and again with farm credit problems in this country.

While we must prevent this system from going under, and we will, underlying everything we are talking about today is the fact that unless farm income stops its slide, farmland values will go down, and the farm credit crisis will continue and get worse over the years.

We have a lot of public policy questions to ask. We have to ask ourselves what kind of regulatory role there ought to be for the Farm Credit Administration. Should it be tougher and stronger than it is right now? How much in terms of Federal cost can we afford? What are the public policy issues in terms of this matter? Who runs the Farm Credit System? Is it your local banker or is it a central authority? Who should it be in order to prevent this problem from getting worse?

We will not let the Farm Credit System go under, but we've got to understand why this thing happened and what steps can be taken. That may mean restructuring the Farm Credit System to some degree.

Finally, Mr. Chairman, a bailout or a Federal infusion of funds, or whatever legislative solution we propose, without the basic farm economy improvement, will go for naught. It will not deal with the problem.

Thank you, Mr. Chairman.

Mr. **JONES** of Tennessee. Thank you very much, Mr. Glickman, for a very fine statement. We do appreciate, as I have told you many times, your splendid cooperation with this subcommittee.

Now Mr. Morrison is recognized for any statement he might make.

Mr. **MORRISON**. Thank you, Mr. Chairman.

I have no statement other than to say that, in the tradition of this subcommittee, Mr. Chairman, I hope that we start right away finding answers. We could all restate the problem from our own geographic perspectives, and that doesn't get us anywhere. We are looking for solutions, and I trust they will come from the expert witnesses that we have scheduled for the subcommittee.

Thank you, Mr. Chairman.

Mr. **JONES** of Tennessee. Thank you very much, Sid. We do appreciate your cooperation and your help through the years.

Now I recognize Mr. Lindsay Thomas for any statement he might have.

OPENING STATEMENT OF HON. ROBERT LINDSAY THOMAS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF GEORGIA

Mr. **THOMAS**. Thank you, Mr. Chairman.

I am sorry I had to miss a few prior comments, but I would like to take just a minute to give a statement or two about my concern on the farm credit issue.

I have felt for a long time, and I think that there are many of us who are close to agriculture who come from the agricultural sector and represent agricultural constituents that, apart from and outside of the major policy issues that are decided in the House Agriculture Committee or the Senate Agriculture Committee, that there has been another growing, steadily burgeoning, snowballing problem outside of this area that has now become a driving force in itself, and that is the credit issue.

It has resulted in a steady decline of land values. It has resulted in, of course, a shaking now in the confidence of this country in the farm credit structure across the board. Many commercial banks have pulled out of agricultural lending. So the credit issue, the high cost of money to farmers pressed with steadily declining profit margins, the reluctance of other lenders to invest in the farm sector, is taking a terrible toll.

I have just two closing statements I would want to make. The first is that I have often pondered, in watching the steady demise of agriculture in this country over the last few years, what it would take to finally get this country's attention. Many have said it would take a shortage of food on the shelves or perhaps some other debacle that nobody could dream up or describe. Well, I personally think that we are looking at the one issue that holds within its capacity the ability to set this Nation's economy totally off track, perhaps even to a state of depression rather than mere recession. I think for once we are looking down the throat of the very monster that is going to get this Nation's attention, and it is going to do it in a decimating manner and a harmful manner if we do not respond in accord.

The second thing that I think is important for us to realize is that there are problems in the credit sector throughout the farm credit area, whether it be the farm credit service, the Federal land bank, commercial lenders, or whoever, and that it is, therefore, nationwide. It is national in its implications. Really when you look for the body or entity who must deal with and grapple with the problem, the one thing that we should not make any mistake about is that the only body that has the ability and the capacity to deal with the credit issue is the very body that the issue is now before.

It has been a long time coming. We have shared responsibility in many areas. It has been done by this administration, and I take my own share of the blame for all of us.

Finally, the problem has arrived to the point and before the body which it will either do one of two things: it will finally step in and make constructive policy or it will shirk its responsibility once again. I shudder to think of the damage that this is going to do not only to our agricultural sector and to rural America, but to every living, breathing American citizen and to the Nation's economy in general.

I hope we are past the point now of saying there is no problem and sweeping it slowly under the carpet and walking over it in our daily capacity, and that we realize that the problem is severe and within it are very dramatic implications that I think will unfold in the course of these hearings and others to come.

Mr. Chairman, I want to thank you for instigating these hearings and making this possible. I simply want to say that I am one who feels that this committee has before it probably one of the greatest responsibilities being faced by this Nation today.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Lindsay, for a very good statement. I want to also emphasize the appreciation that this chairman has for your cooperation with the subcommittee.

Now to Steve Gunderson, a member of the subcommittee, for any statement he might want to make.

OPENING STATEMENT OF HON. STEVE GUNDERSON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WISCONSIN

Mr. GUNDERSON. Thank you, Mr. Chairman.

I, like everyone else, would ask that my full statement simply be made part of the record.

Mr. JONES of Tennessee. Without objection.

Mr. GUNDERSON. I want to apologize that I, like Mr. Coleman, have that same Education and Labor Committee markup which is going to require some absence for me this morning.

I think the first question that needs to be asked is: Will a morning full of testimony from Members of Congress achieve anything? I suppose the cynics among us could say it will not, but I would suggest it is significant and historic from two different perspectives. I think, No. 1, it indicates the universal concern for the Farm Credit System is bipartisan and throughout all regions of the country. As a result of that, I think it also indicates a message that must go out, and I think an important message that must go out, to many of those farmers involved in the Farm Credit System today that that system will be preserved; its integrity will be maintained; and that ought to be not in the question.

The real issue in farm credit in the magnitude of what we must do in this credit subcommittee I suspect will be determined by what happens to the farm bill and the whole question of farm income in this country.

I have consistently heard from the St. Paul district where I come from that the magnitude of the troubles they will face in the future will be determined really by the question of farm income. If you look at the beginning significant rise in nonperforming loans that is already mounting up in each of these district banks, and I think many of us are concerned will increase much more so this fall, then you quickly recognize that we are going to give a temporary solution in this subcommittee. The long-term solution must come from the whole agricultural sector.

I would, however, hope that we do not get into the mentality of Farm Credit System bashing this morning or throughout this hearing process. I have to say in defense of the Farm Credit System that I think they have done what every member of this subcommittee, every Member of this Congress, and every member of the administration, frankly, wanted them to do, which was try to solve their problems as best they could themselves before coming to us. Had they done anything else, we would have sent them back home to try to make that effort.

As a result of that, we also ought to recognize that everyone on this subcommittee—certainly the chairman has held numerous meetings in the last couple of years with the Farm Credit System.

It came as no surprise to him. It came as no surprise to most of us that there was a problem that eventually would require some Federal attention from the Congress and the Federal Government.

What ought that response be? I think we all recognize we are probably looking at a one-time infusion of capital. I think we are looking at some kind of guarantee in the system, some clear evidence that the Federal Government will stand by the Farm Credit System now and in the future, and I think we are also recognizing that the Governor of the Farm Credit Administration needs more authority than he has had in the past. None of this deals with the question of restructuring. None of it deals with the problems of how do we deal with the nonperforming loans. There are many and varied suggestions. My colleague from Iowa is probably our main expertise in that area. I am not ready to say one or the other of those is right, wrong, or in between, but I think that clearly this subcommittee, with the distinct leadership of our chairman, will do its job. That ought to be the message that goes out to America today.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Gunderson follows:]

STEVE GUNDERSON
3D DISTRICT, WISCONSIN

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OPENING STATEMENT OF THE HONORABLE STEVE GUNDERSON
SUBCOMMITTEE ON CONSERVATION, CREDIT & RURAL DEVELOPMENT
SEPTEMBER 11, 1985

Mr. Chairman and Subcommittee Colleagues:

As we begin consideration of the financial problems confronting the independent Farm Credit System in the United States, I would first like to thank the Chairman for holding this set of hearings and permitting me to include a few brief remarks at this point in the record.

Last week, articles in the Wall Street Journal and the Washington Post made the entire country aware of the serious financial problems facing the Farm Credit System. For farm state legislators who have lived with the farm credit/farm income crisis on a daily basis for many months, the news was not surprising.

When the House debated emergency farm credit legislation last February, I referred to the farm credit situation as "a volcano that is about to erupt." Well, the lava is pouring out of the crater now, and it is time for Congress to act so that rural America does not become another Pompeii.

THE PROBLEM

The financial stress confronting the Farm Credit System can be stated simply: it has $11.1 billion of uncollectable loans--15 percent of the system's $74 billion loan portfolio. This figure is said to be somewhat conservative according to several farm economists.

That's significant to the agricultural sector of our economy--and our country as a whole--because the Farm Credit System holds 35 percent of America's $215 billion farm debt. With land values and farm income unlikely to bounce back in the near future, this situation is not going to improve soon.

THE SITUATION IN THE UPPER MIDWEST

My Congressional District is part of the Seventh (St. Paul) Farm Credit District which services Michigan, Minnesota, North Dakota, and Wisconsin. While the St. Paul District has not experienced the specific difficulties that the Spokane and Omaha Districts have (which have received in-system aid packages of $125 million and $435 million to off-set lost earnings, respectively), it has its share of non-performing assets (about $400 million in 1984). And almost $80 million of that had to be written-off. It doesn't take a mathematician to figure out that there is a significant loss in earnings associated with those figures.

Both the losses within the District and the losses within the System as a whole directly affect Seventh District borrowers for, as a cooperative system, the system absorbs the financial troubles of a particular district. As such, in a time when the prime interest rate is declining, interest rates to Seventh District borrowers are escalating. And at a time when net farm income is already diminished, the last thing farmers need is higher interest rates.

Accordingly, it is clear that we must work with the Farm Credit System to resolve its financial crisis--and the crisis of its borrowers--now. We cannot afford to let it linger.

POSSIBLE SOLUTIONS

Individuals both inside and outside the Farm Credit System have presented ideas to resolve the financial stress felt by the Federal Land Banks and Production Credit Associations nationwide.

In recent months, the System itself has suggested four alternative courses of action to stabilize their operation: 1) the formation of an Agricultural Conservation Corporation, financed by the Federal government, to buy foreclosed farms and bad loans to bolster land values; 2) The selling of tax-exempt bonds to provide a new source of capital to the System; 3) the establishment of greater powers for the governor of the Farm Credit Administration to direct the everyday operations of the various districts; and 4) the provision of immediate capital to the system.

In addition to the system's proposals several bills have been introduced. Of particular interest are three pieces of legislation drafted by our colleague Mr. Evans of Iowa. The first bill would make an infusion of $5 billion into a central reserve, fix loan rates, set lending limits of $200,000, and arm the Governor with power to issue temporary cease and desist orders.

The second would further strengthen the Governor by allowing him to temporarily reduce the capital requirements of a bank or association and by authorizing him to provide capital, with certificates as partial payment, for the purchase of foreclosed farmland or mortages on farmland. The third bill, The Farm Credit Bond Act of 1985 (H.R. 3231), which I have co-sponsored, would establish the United States government as guarantor of bonds issued or consolidated by the System from now until 1988.

THE DIRECTION WE SHOULD TAKE

The simple facts are that no single course will be sufficient to meet the growing problems of the Farm Credit System. Rather, it seems to me that we need to move in several directions at the same time.

First, we need to address the immediate monetary needs of the System. In conjunction with existing reserves, we must consider a one-time infusion of capital into the System. In saying that, I reject the notion that this is a "bail-out" of private enterprise. After all, the Farm Credit System was captalized with Federal revenues--money which it repaid through the years just as any reissuance of that capital will be repaid in the future.

Secondly, we must provide the System with a way to attract funding in future years. It occurs to me that we can do that by maintaining public confidence in the System much as we do for other financial institutions through investment guarantees such as those contained in H.R. 3231.

Thirdly, we need to arm the Governor of the Farm Credit Administration with sufficient regulatory tools to assure that the current situation does not recur. A system that seeks help for an ailing district from other member districts ought to have strong central management.

Finally, and most importantly, we must realize that this is temporary assistance. The fact of the matter is that no recapitalization or other monetary help for a cooperative financial network will solve the problems of its member-organizations if its borrowers cannot repay their loans. Thus, the long-term solution to the situation facing the Farm Credit System lies in the many variables which control farm income--fiscal policy, monetary policy, trade policy, and the Farm Bill.

I, therefore, look forward to the testimony that will be presented today and the rest of this week on this pressing problem as well as working with my colleagues on its resolution. Again, Mr. Chairman, thank you for this opportunity to address the Subcommittee.

Mr. JONES of Tennessee. Thank you very much, Steve, for a splendid statement. I want to emphasize, also, how much we appreciate the cooperation that you have always lent this subcommittee.

Now to Lane Evans. I was going to recognize him, a member of the subcommittee, for any statement that he might have.

Lane, do you have any statement you want to make?

Mr. PENNY. He was here a minute ago.

Mr. JONES of Tennessee. Then I will pass on to Mr. Stenholm for any statement he might like to make.

OPENING STATEMENT OF HON. CHARLES W. STENHOLM, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. STENHOLM. Thank you, Mr. Chairman. I, too, may have a prepared statement for the record.

I would just say that there is no doubt in my mind that under your leadership and the work of this subcommittee that we will steadily, credibly, and helpfully devise the policy changes and other actions necessary to deal with the problems that we confront in the agricultural credit area and look forward to working with you and members of the subcommittee and hearing from our witnesses.

Mr. JONES of Tennessee. Thank you very much. I do want to emphasize to you, Charlie, how much we appreciate the splendid support and cooperation that you have always given the subcommittee and the chairman.

Now to a very stalwart member of the subcommittee, Cooper Evans of Iowa.

OPENING STATEMENT OF HON. COOPER EVANS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF IOWA

Mr. EVANS of Iowa. Thank you, Mr. Chairman.

I want to join my colleagues in complimenting you for having this hearing.

I do have some very short remarks at this point. Later I would like to testify on a more technical basis, if that is possible.

At this point I would like to talk for just a moment about the situation that exists with a typical borrower of the Farm Credit System within the State of Iowa. This example, Mr. Chairman, comes from real life.

The gentleman that I am describing is an extremely capable, able, efficient, conservative farmer who raises corn in my district. The land that he farms was worth $3,000 an acre in the go-go years of the late 1970's. In order to defend himself against inflation and the rapid expansion in world demands for our goods, he and his financial advisers concluded that the only responsible thing for him to do was to have about $1 in debt for every $3 in assets that he controlled. In other words, he owed $1,000 on each acre that was then worth $3,000. He entered into those contracts to borrow money from the Farm Credit System at essentially 7 percent interest.

Today, that $3,000 land is worth $1,100 or $1,200 on the market in Iowa. He still has the $1,000 in debt. The interest charges on that $1,000 in debt have gone from 7 percent to 14 percent. What does that do to his cost of production? His interest charges on an acre of land are today $140 an acre. His annual principal charges on that 20-year loan are $50 an acre. His production costs, therefore, for corn from his point of view are $190 an acre just to service that debt. He raises about 120 to 130 bushels of corn on that acreage. The bottom line to him is that, because of his Farm Credit System problems, his costs of producing a bushel of corn are increased by about $1.50 a bushel just to pay his obligations to the Farm Credit System.

To put that in perspective, the total price of corn as we support it under the loan is only $2.55. The target price is $3.03 in the new bill. That loan rate is probably going to be decreased under the new bill.

It is totally impossible for him to solve his problem without some substantial changes in how that problem is handled. That is, in my judgment, the basic issue before this subcommittee as we try to provide some assistance to agriculture. Mr. Chairman, somewhat later I would like to explain to the subcommittee some thoughts on the menu of possible actions from which this subcommittee might select a solution.

I thank the chairman very much.

Mr. JONES of Tennessee. Thank you very much, Mr. Evans.

I also want to emphasize the splendid cooperation that this subcommittee, and this chairman especially, always receives from you.

Are there any other opening statements from members of the subcommittee for the record?

[The prepared statement of Mr. Stallings follows:]

September 11-12 Hearing on Farm Credit Crisis
Mr. Stallings' Remarks before the Subcommittee on Conservation, Credit and Rural Development

Today the House Agriculture Committee has completed its work on a five-year omnibus farm bill which will preserve the basic income protection programs so vital to rural America. I strongly support this bill for its efforts to restore profitability to American agriculture. I also endorse the new trade expansion programs that will help make American products more competitive in world markets and conservation measures that will help reduce overproduction while improving the productivity of our precious natural resources.

For the first time in months I am optimistic about the future of our farm economy and I want to share this hope with our farmers. I have not, however, lost sight of the severe financial problems still looming on the horizon. The newspaper headlines across this country testify to these seemingly unending agricultural problems. One such headline--"A Year of Travail for Gem State Farmers"--perhaps sums up the situation in my homestate of Idaho.

Three months ago I challenged the Idaho director of the Farmers Home Administration when he claimed that our state's agricultural problems "have been considerably overstated" and that "the media and the politicians played it to the hilt." I think the federal officials were wrong then in not recognizing the extent of the current agricultural financial crisis and would be grossly negligent now if they don't acknowledge the problems and work cooperatively with Congress to find a solution to these problems.

The Governor of Idaho recently commissioned a survey of farm credit in our state. This study reveals that while Idaho has not yet experienced the number of farm liquidations and social disruptions that have been so well documented in the Midwest, there is a definite sign of financial distress in Idaho's farm-based economy. The debt-to-asset ratio for Idaho farmers averaged 34.1 percent which is much greater than the national average of 20.8 percent and even higher than the 22 percent recorded for Missouri, which claims to have the highest FmHA delinquency rate. The survey went on to conclude that unless there is a dramatic turn around in the farm economy, Idaho is likely to lose 10 percent or more of its 24,600 farmers.

And now we are told that the Farm Credit System which provides more than 35 percent of this country's $215 billion farm debt will need "billions of dollars" of federal assistance to keep the ailing System solvent. I think this is a clear enough signal that Congress and the Administration must tackle both the root causes of this crisis--a lack of farmer income--and the immediate monetary needs of the Farm Credit System. And we must act now. I am very pleased that the House Agriculture Subcommittee on Conservation, Credit and Rural Development has accepted this challenge and is taking the necessary first step in holding hearings on agricultural credit conditions in rural America.

Mr. JONES of Tennessee. Now are there other members of the subcommittee in the audience who would like to make a statement before we proceed with the witnesses?

[No response.]

Mr. JONES of Tennessee. If not, we move to the witness list. Those appearing on the witness list are, first, the Members of Congress who are members of the committee. I will call their names in order. If they are not here, we will move to the next member. If he is not here, we will move to the next one, and so forth until we arrive at somebody who is here. That is the custom of the full Agriculture Committee as far as witnesses go. The first member on the committee is Hon. Berkley Bedell. Mr. Bedell is apparently not here.

The second witness is Hon. Ron Marlenee. Apparently he is not here.

The third member is Hon. Larry Hopkins. Congressman Hopkins is here.

Larry, thank you for appearing. You may proceed. I don't know whether you were here when we made the opening statements or not, but be as brief as you can but do what you want to do. Your full statement will be made a part of the record, without objection.

STATEMENT OF HON. LARRY HOPKINS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF KENTUCKY

Mr. HOPKINS. Thank you, Mr. Chairman and members of the subcommittee.

I would like to thank you, first of all, for calling this hearing to discuss current problems in the Farm Credit System.

This hearing is especially timely in light of the House Agriculture Committee's action last night to report a farm bill to the full House for consideration.

We are all discovering that problems with the Farm Credit System are becoming as important to the farmers we represent as the makeup of the farm bill which just passed. Frankly, I think this issue took most of us by surprise.

The Farm Credit System has performed its duties with relatively little congressional involvement since its beginning in 1916. As members of the House Agriculture Committee, we are used to dealing with issues involving the Farmers Home Administration. However, when problems with the Farm Credit System emerged, I had to go back and do a lot of homework.

I have had meetings and correpondence with interested shareholders and local directors in my district over the August recess. Two main concerns have been expresed to me, Mr. Chairman. First, borrowers are concerned about the recent increase in interest rates. On June 1 they went from 12.75 percent, as you know, to 13.25 percent. This has been explained as a symptom of the weak financial condition of the system. However, it is also increasing the problem by driving the good risk borrowers out of the system and into the arms of private lenders.

The second concern expressed in my district is over proposals to merge the association into one district. Many local association directors in my district understand the serious financial condition of the system. However, they do not want this concern to be used as a smokescreen to make further changes that are unwarranted and undermine the congressional intent of the Farm Credit Act that the System be farmer owned and operated.

Concern has been expressed that directors of local associations will no longer be needed; member loans, while serviced in the same area, will not have the benefit of a local board hearing before foreclosure or certain other servicing is applied to the loan; decisions will be made by a small number of people at a centralized location. The employees of the System would be directly responsible to one person and the bank president would amass tremendous power. These and other reasons could erode confidence in a system no longer controlled at the grassroots level. These, Mr. Chairman, are most of the concerns expressed to me.

This is not to say that local associations are not willing to respond to the problems of the system. Indeed, I think most would support the original proposal to reduce the number of associations in the Fourth District down to 28. And they have also asked that loss sharing agreements be used instead of forcing all of their assets to be sent to one super association with no possibility of payback. They are concerned that time and energy is being spent on merger proposals which may have little or no effect on the financial soundness of the system when efforts would be better spent strengthening the system.

The forced merger issue concerns me because of its possible violation of the congressional intent of the Farm Credit Act. The act clearly provides that associations can merge. However, if coercive measures are used to intimidate associations into agreeing to merge, that, to me, is no longer in accordance with the current law. Of course the Congress may change this law as it sees fit, but changes in the law must be made by the Congress, not by the district boards of the Farm Credit System.

As I said earlier, Mr. Chairman, I have been subjected to a crash course on the Farm Credit System spurred by the concerns of my constituents. I do not claim to be an authority or have all the magic answers. I am hoping that the information provided here during the next 2 days will help me decide what action should be taken. At this point I simply want the subcommittee to be aware of the concerns I have had expressed to me over the recent few weeks in my district. I am looking toward this committee, this subcommittee, for solutions to our problems.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Hopkins appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Larry, for a good statement. The next witness on the list that was present at the time we opened the hearing is the Hon. Arlan Stangeland from the State of Minnesota.

Arlan, you may proceed.

STATEMENT OF HON. ARLAN STANGELAND, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MINNESOTA

Mr. STANGELAND. First of all, Mr. Chairman, I want to express my personal appreciation to you for scheduling this series of hearings and for your well-known sensitivity to the severity of today's agricultural credit crisis. Your leadership and that of the ranking minority member, Mr. Coleman, and this whole subcommittee, in this most crucial area I think is well known. I am hopeful that these hearings will serve as a catalyst for thoughtful congressional initiatives to adequately address the uniquely difficult credit problems now facing American agriculture.

Mr. Chairman, I commend you for holding these hearings on the Farm Credit System, but I would hope that you would keep the scope of these hearings broad enough to cover other initiatives and ideas in credit financing for agriculture.

I think we just have to look at today's headlines and recent headlines: "More Farmers Overextended," "Farm Land Values Continue to Fall," "Agricultural Problem Banks Reach Record Numbers," "Farm Credit System Faltering," "Multibillion Dollar Credit Bailout Needed."

What is the answer during this time of $200 billion deficits? When Federal resources are already stretched to the breaking point, can we afford the major new initiatives that seem necessary to patch up an extremely ailing agricultural credit system?

I don't think there is anyone on this subcommittee, the full Agriculture Committee, or anyone who is closely associated with agriculture who doesn't believe that the only real long-term solution must involve farmers getting a decent price for their crops.

But in the absence of a modern day miracle, that is not going to happen soon. In the meantime, I think we must search for creative ways in which to manage a snowballing situation that fundamentally threatens the very foundation of American agriculture and our entire economy.

Farming is an extremely credit capital intensive business. Without access to a reliable and reasonably priced credit source, American agriculture cannot survive. And if the $74 billion Farm Credit System and the countless rural banks that heavily depend upon agricultural loans for the bulk of their credit portfolio are not adequately assisted, I truly fear that the ever-widening gulf of misery now being experienced in agriculture could swallow the entire country.

I just want to divert from my prepared text briefly to say that I am really, truly disappointed that not enough people here in Washington are understanding and knowledgeable about the problems that are out there in rural America, because I am not one who preaches gloom and doom or cries wolf; I'm an optimistic, positive kind of a person, but the situation is severe and it is critical. I think it has to be recognized here on Capitol Hill and downtown in the White House, with more recognition than what it has been given up to this point.

Those of us who are close to it, the members of this Agriculture Committee, this subcommittee, are aware, but I think we need to make other people aware of how severe the situation is; that it is a crisis.

I cannot say what the total answer is as far as the beleaguered Farm Credit System is concerned. Mr. Chairman, I know that these hearings will bring out some of those problems for this subcommittee, and this subcommittee has the expertise to deal with that.

I think we ought to consider some various policy options that are going to be necessary to assure the system's solvency and future viability as a major source of producer credit in this country.

But I do want to take just a short time to briefly explain and urge my colleagues to look at a bill that I have introduced, H.R. 2064, which I believe offers some interim credit relief and hope for hard-pressed farmer borrowers.

H.R. 2064, the Modified Debt Recovery Act of 1985, was originally proposed by a farm organization in my district, Communicating for Agriculture. It has since been endorsed by the Minnesota Farm Bureau, Minnesota Farmers Union, and the Minnesota chapters of the National Farmers Organization and American Agriculture Movement. In addition, the Minnesota Bankers Association and Independent Bankers of Minnesota, along with numerous commodity groups, as well as agribusiness, have also expressed their support for the CA debt restructuring plan.

While I won't go into every detail of the bill, let me explain five major features of the Communicating for Agriculture Modified Debt Recovery Program, as contained in H.R. 2064.

One, the provisions contained in H.R. 2064 call for commercial lenders, under the Farmers Home Administration's Approved Lenders Program, would be authorized to process FmHA regular and limited resource direct loans, in addition to their present authority to process FmHA guaranteed loans. The Farmers Home Administration would retain final authority to accept or reject the loan application.

Two, an interest rate ceiling on FmHA guaranteed loans, under the Approved Lenders Program, would be set at 2½ percent above the Federal Reserve discount rate.

Three, an approved commercial lender would be authorized to find the proper blend of Farmers Home Administration loan guarantees and regular or limited resource direct loans so that the farmer's operation would show a positive cash-flow. Farmers Home Administration would always maintain the authority to reject any proposed credit package that did not appear prudent.

Four, any time the approved commercial lender included Farmers Home Administration direct loan moneys in the farmer's credit relief package, the level of the Federal guarantee on the remaining loan guarantee portion of the credit package would be set at 60 percent, instead of the normal 90 percent Farmers Home Administration loan guarantee level.

Five, on any such Farmers Home Administration loan guarantee and direct loan package processed by an approved lender, the security on the entire credit package would be allocated between the private lender and FmHA on a prorated percentage basis according to the degree of each lender's exposure. Presently the security is itemized for each FmHA loan.

Mr. Chairman, H.R. 2064 may not be the total answer, but I think it is a start. It would lower interest rates, ease repayment terms, improve the turnaround time on loan paperwork, equitably share the risk between private lenders and the Federal Government, and offer some hope to the financially squeezed farmers.

During this time of severely limited Federal resources, we can't do everything, but we cannot afford to do nothing. The CA plan offers what I believe is a balanced blend of risk-sharing by the private lender, the farmer, and the Federal Government.

The author of the CA plan, Mr. Rollie Lake, is a retired agricultural banker. He has testified before the committee before. He is a constituent, a long-time friend, and is presently serving as president of Communicating for Agriculture. I hope that you will listen closely to his testimony later today and carefully consider the 20 years of agricultural lending experience that he has called upon in crafting his very thoughtful proposal.

In addition, let me briefly mention one other proposal that has come to me just in this past year. This proposal is made by a constituent of mine who serves in the Minnesota State Legislature, State Representative Meryl Valan.

Representative Valan is advocating the creation of State agricultural bond programs, incorporating both State and Federal tax incentives, to provide low-interest debt restructuring loans for family farmers.

Although the watch words in Washington, insofar as the Federal Tax Code is concerned, are "simplification" and "streamline," I think there may be some merit to exploring these ideas and any others which offer some hope of stabilizing asset values in rural America.

Again, Mr. Chairman, thank you for your concern. Thank you for allowing us to testify here. I am hopeful that you and this subcommittee will be able to use these hearings as a springboard to launch meaningful debt restructuring and credit relief for those hardworking men and women who will otherwise be forced off their farms.

I thank you very much.

[The prepared statement of Mr. Stangeland appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Arlan, for a very good statement. We do appreciate the wisdom that you have shown this entire subcommittee as far as farm credit problems are concerned.

Before I call the next witness, there are two things I would like to do. If there are any Members of Congress who are here this morning and would like to have a seat with the full subcommittee, I would be glad to invite you to come with us and to have a seat.

Mr. Bereuter has already arrived, and anybody else that is in the audience, we would be pleased to have you. If the staff sees somebody later, be sure to invite them in.

The next member who is here and is, no doubt, ready to testify is the Honorable Pat Roberts from the State of Kansas.

Pat.

STATEMENT OF HON. PAT ROBERTS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF KANSAS

Mr. ROBERTS. Thank you, Mr. Chairman.

I think the record should reflect that with these hearings today, we are going down a difficult road both in the subcommittee and the full committee, and the entire Congress to address this problem and to restructure the Farm Credit System. I think that is what is coming.

Let the record show that whatever path we take, whatever road we take, it will be constructed in a fair manner by the chairman. I think that the end result, when we finally do address the problem and have the answers, that we will have a sign on the road, Mr. Chairman. It will say, "This road was constructed by Ed Jones of Tennessee and Tom Coleman of Missouri."

I used to serve on this subcommittee. I wish I did now, but there are other duties that do prevail. It is good to be back.

I would guess there are a lot of questions on the part of the press and the audience here as to why we have this hearing and so many Members of Congress are testifying. I do know that you have scheduled hearings later this month where our farm credit officials will be here and the USDA will be here, and what my friend Mr. Evans of Iowa says is true—we will go down the menu on the plate.

The reason is because we are so terribly concerned over the problem.

I would hope with the testimony of all these Members, it would become required reading at the White House, at the USDA, within the Farm Credit System, and really become a focus of debate all throughout farm country.

I just finished up, as did the rest of my colleagues, a 58-county district tour in our big first district. That goes 4,000 miles and takes us about 3 weeks. Every county courthouse stop I made, Mr. Chairman, the No. 1 concern was the stress being felt throughout our entire farm lending structure.

I want to stress that point. This issue not only affects the Farm Credit System, but our commercial lending institutions as well.

I am not talking about adding any more credit. I think that is most unfortunate in terms of the debate that is being framed and some of the comments that are actually appearing in the press. We don't want any more credit in farm country. We have dug that hole about as deep as we can dig it. What we are talking about are actually the walls of our credit home, of our entire farm lending structure. If you don't have a credit home, obviously you can't operate.

I have a full statement, Mr. Chairman. I would ask permission it be made part of the record. I will simply paraphrase from it.

Mr. JONES of Tennessee. Without objection, the full statement will be made a part of the record.

Mr. ROBERTS. Last week we heard the farm credit folks do an about-face and say that they will need help from the Federal Government within 18 to 24 months. I think that was the statement. I quarrel with that timeframe. I think the time is now.

This admission, by the regulatory agency responsible for the entire Farm Credit System, sent what I worry could be permanent shock waves and signals to the bond markets. Unless we act to address this problem and go through the necessary policy debate to pass some kind of a package here, I think this problem will persist.

Right off the bat, Mr. Chairman, in the short term, because of the recent publicity on the overall health of the system, the current bleak outlook for the farm economy, and the uncertainty that this has created, I think we should enact legislation, clearly stating that the Federal Government does stand behind the bonds of the Farm Credit System. Many of our investors have bought the farm credit bonds under the understandable but mistaken notion that they are federally guaranteed. As I say, the recent publicity on the Farm Credit System is creating additional uncertainty.

Now my good friend and colleague to my left over here, Congressman Cooper Evans, has introduced, and I have cosponsored legislation that does provide for a Federal guarantee of the farm credit bonds. I think this type of legislation, or at the very least, a sense of Congress resolution, spelling out the intent of Congress, similar to what has been passed in the Senate just prior to the August recess, will certainly help to calm the current uncertainty.

As to the specific menu on the plate, I have several suggestions or several comments. First, it is time for the system as a whole to stop raising interest rates to build reserves. The farmer has paid slightly higher interest rates from the day the Farm Credit System was created to build these reserves. If my calculations are correct, the system has $3.4 billion in liquid reserves. Of that $3.4 billion, about $500 million has been used already or will be used for the Omaha and the Spokane banks in terms of loss-sharing agreements. That leaves nearly $3 billion in liquid reserves. Those reserves were built up for a rainy day. It is not only raining, hail is predicted. It is time for the system to commit those reserve.

Second, while it is important for the Farm Credit System to commit those reserves, they clearly may not be enough. We are talking about a $75.8 billion system, with potential bad loans of up to $15 billion. I think, without question, since it was Government in part, due to market intervention and other policy directives, that really helped to start the mess we have out in farm country, right now it should share in the cost and burden of solving the problem.

But let me caution this subcommittee and my colleagues that the farmer and the Farm Credit System does not want a Continental Illinois style bailout. Time after time I heard on my district tour, "If we can bail out Continental Illinois, why, certainly we can address this system with some kind of help."

When the Federal Government bailed out Continental Illinois, the Government took over all of the owners stock and replaced the entire management team with hired guns to put the bank back on its feet. The Farm Credit System should retain the local involvement that is the cornerstone of the system. If it was any concern over and above the structure and the integrity and the strength of the Farm Credit System that I heard on my tour and that my colleagues hear time and time again, it is that we must rely on local control.

I think any rescue plan should consider giving the Farm Credit Administration regulatory powers to prevent any repeat occurrences of the situation we have today. In addition, I would encourage this subcommittee to look at the possibility of establishing something similar to what we have for commercial banks and savings and loans, that is, an insurance fund with appropriate incentives and parameters—something very similar to the FDIC fund.

It is my understanding that the Farm Credit Administration, the Farm Credit System, and the administration are looking at various options and plans to remove the bad paper from the system, such as an Aggie Mae loan guarantee program. It is my understanding as well that some of these contingency plans or legislation of this type is being considered by a White House task force. At present we don't have any specifics, but I would urge that task force to move expeditiously. I would just issue a warning that if, in fact, that is not the case, there will be Members of Congress who will have this kind of legislation and have it introduced very quickly.

This would involve the system, the Government, and perhaps commerical banks pooling $3 to $5 billion. With a Federal Government guarantee, this could then be leveraged to $30 to $50 billion to purchase and hold nonperforming loans that the Farm Credit System and the commercial banks now have in the loan portfolios.

I want to mention one last issue, Mr. Chairman. It is outside the fence but in the same pasture of what we are talking about. I want to stress the issue of the lack of forbearance in farm country on the part of the regulatory agencies in the field who have the responsibility of protecting our entire lending structure.

Now we happen to have the Kansas Bankers Association in town this week, along with a lot of other folks. They have met with Mr. Isaacs of the FDIC. They have met with the Comptroller General. They have met with Mr. Volcker. We repeatedly get these two-page, single-spaced memos stating the policy of forbearance in farm country. I am probably walking on eggs here and sort of treading on a limb in terms of congressional responsibility, because all of these regulatory agencies are independent. We have to practice oversight responsibility, Mr. Chairman, but I don't think we want to get into their business and meddle too much. They are getting a little thin skinned when they read their names in the paper and some of the criticism that has been taking place.

I would tell you there is a great disparity between what is happening in farm country in the trenches when an unmarked car pulls up in front of the bank and 10 bank examiners get out like a plague of locusts and descend on the bank, stay there for 10 days, scare the heck out of the bank and the heck out of the community, and all of a sudden arbitrarily 90 days after the last bank exam reduce our land values by 30 to 40 percent. It is killing agriculture.

In my personal opinion, the lack of forbearance in the field as compared to what is stated policy here in Washington and the regional offices is part of the problem, not part of the answer.

Those are harsh words. I intend them to be.

As a matter of fact, as I see forbearance in farm country, it amounts to this: "not on my watch and protect thine posterior." I'm getting tired of it. I'm getting tired of these kinds of tactics. Some way, Mr. Chairman, if we can hold hearings and some way we can address this problem, it is time for those folks to just stop forgetting about their thin skin and face up to the reality there is no forbearance in farm country.

I have some very strong feeling about that, as you can tell.

I thank you very much for the opportunity to testify before the subcommittee.

[The prepared statement of Mr. Roberts appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Pat Roberts, for a very good statement as usual. I must tell you and confess to you that we do miss you on the subcommittee.

The next witness to be called and who was here at the time the witness list was begun is the Honorable Cooper Evans, a member of the subcommittee, who will be heard at this time.

Mr. Evans.

STATEMENT OF HON. COOPER EVANS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF IOWA

Mr. EVANS of Iowa. Thank you, Mr. Chairman.

Again, I join my colleagues in complimenting you for having these early hearings. We have placed the Agriculture Committee in the lead in addressing this question in Congress. I think that is very fitting and appropriate.

I would also like to take this opportunity to compliment Governor Wilkinson on his statement last week bringing before the public the fact of the need for assistance to the Farm Credit System. I think both of those steps by you and by the Governor were essential preliminaries to any action, and they are most timely.

What we have to do now is to seek a consensus on what the Federal Government will do. In seeking that consensus, I think there are four broad questions that have to be addressed by this subcommittee.

The first of these is, who should take the hit for the losses? There are massive losses out there. Are those going to be absorbed by the farmer borrower? Are they going to be absorbed by the Farm Credit System? Are they going to be transferred to the taxpayers or are the risks going to be assumed in part, at least, by the bondholders?

The second broad question, and one of great importance to Congress at this time, I think, is this: To the extent we are going to have to provide financial relief, to what extent are we going to do it upfront with appropriated funds and to what extent are we going to address the problem in more subtle means, such as through guarantees that may result in long-term obligations in the Government but do not show as a cost on appropriation bills or budget deficits, at least on paper?

The third broad question I think we ought to address is: Are we going to attack just the problems of the Farm Credit System and attempt to help that system or are we going to broaden the agenda and provide some assistance for all agricultural lenders, including the commercial banks?

The fourth broad question that is of concern to me is: Are we going to attempt to extend help to all agricultural borrowers or are we going to attempt to target solutions merely toward those who are in trouble?

Fortunately, there is a wide range of technically useful possibilities for providing financial assistance by the Government, some under existing law; some require new legislation.

In the time available to me this morning I would like to review a number of the possibilities that exist to address these problems. I do so without any effort to press one above another in terms of my personal favor, but I do think it is important to give us an overview of the various directions that we might go.

I think one has to start with what the act itself says, the Farm Credit Act that was written many years ago. The possibility that the System would encounter difficulties is not something that is of recent development. It was considered by the authors, of the Farm Credit Act. I think it is interesting to note that they had some ideas at that time on what might be done under these occasions.

For one thing, the act provided for and there exists in the Treasury deposits at the present time, as many of the subcommittee members know, a revolving fund. This is money that was used by the Farm Credit System at one time and has been repaid to the Treasury and is now sitting there in several accounts. The total amount in those accounts, as I understand it, is somewhere on the order of $200 million. That is not a large sum compared to the $10 to $20 billion of questionable debt that the Farm Credit System has, but it could play a useful role in any attack upon the problem.

The authors of that legislation also recognized that at some point the System might have a liquidity problem and did provide that under those circumstances funds from the Treasury, I believe at the discretion of the Secretary of the Treasury, could be deposited within certain limits within the System, to solve that liquidity problem.

The authors also recognized that at some point there might be a capital problem in the system, as there was when the system was first formed. So it provides that Congress may appropriate money to the Governor of the Farm Credit System, and the Governor of the Farm Credit System may use that money to buy capital stock in troubled institutions on a reimbursable basis that would be eventually repaid to the Government.

None of those solutions has been seriously considered I think up to this time. I repeat, I don't necessarily recommend them, but I think we should be aware of them.

I think it is important to note, however, that the act provides that if you follow any of these approaches, some undesirable things happen from the standpoint of the Farm Credit System.

The first of these is that the Governor serves at the will of the President. That is not the case at the present time.

The second is that the whole Farm Credit System comes under something that has long been on the books called the Government Corporation Act, which imposes great restrictions upon the operations of that System, and in the judgment of many people would make the operation of the system totally unworkable.

There are also, of course, under the powers of the act a number of internal measures that the Farm Credit System can take itself. As has been noted here earlier today, we have and the administration has I think said to the system, "You must do everything you can within your own power to solve your own problem before you come to us for assistance."

I would say that the Farm Credit System has been pursuing that with great vigor. It has worked much to the disadvantage of farmers, because one of the things they can do within the system to help themselves is to raise interest rates, and they have done that with great, if not with enthusiasm, certainly with great vigor. I think that route has been pursued further than it should have been and cannot be pursued any further.

The second thing that they have done in many areas is to freeze stock in order to preserve their capital. If you pay off your loan, you cannot get recovery of your stock that you have in the institution. I think that that should not be pursued further.

I think further actions of that type within the system will only alienate a lot of the good borrowers and encourage those borrowers to leave the system.

Another thing they can do is to consolidate into fewer and larger organizations. Now the reason that that has a bearing on their problem is that the reserves of that system, $3.4 billion that Mr. Roberts spoke about, are not readily available to the system as a whole. It is scattered throughout all of the banks. It is scattered throughout all of the associations. Barring defaults on the bonds, it can only be brought to bear on the problem under voluntary arrangements.

If you consolidate the systems, if you consolidate associations, you can bring those reserves together. In pursuing that business of consolidation, they really are following the direction of this administration and the leadership of this Congress who say, "Fellows, you've got to do everything you can to correct your own problems internally before you come to us for help."

So much for the act itself.

Second, I think the subcommittee needs to recognize that sitting on the sidelines and somewhat aloof from all the fray at the moment but a very powerful force in this whole arrangement is the Federal Reserve Board. The Farm Credit System as a separate, independent commercial bank has access to the Federal Reserve Board just like the other banks of this country, if everybody agrees that that should be so. I have been assured that the Federal Reserve Board has addressed this problem and is quite willing to step in and provide the kind of assistance that it can. As a matter of fact, it has adopted some programs especially for the Farm Credit System under their seasonal loan program through the discount window. That has not been used at this point.

They can open the discount window to the Farm Credit System if the Farm Credit System wishes to take advantage of that. The Farm Credit System has not done that yet. There are good reasons why they have not. There would be no great advantage in the interest rates up to this point as opposed to borrowing on Wall Street.

One of the limitations on that particular route is that, while it can help a liquidity problem within the Farm Credit System, it provides absolutely no relief if your problem is loss of capital. There is no way that the Federal Reserve Board can address that problem of loss of capital.

I would also say that the Federal Reserve has another very powerful tool that it can use, and that is the purchase of Farm Credit System securities either on the primary or secondary market in New York City. If they see those interest rates rising for the Farm Credit System, they can step in and stabilize that market just as they do in some of the other markets for Government or agency securities. There is no official way of knowing whether they have done that up to this time, but they certainly can do that at any time that they wish to do so.

To move on to other provisions within existing statutes or the capabilities and authorities of existing organizations, I think it is interesting to note that tremendous relief could be provided under a program already authorized by this administration and in place, if the administration or Congress, wished to use that route. That would be to broaden the Farmers Home Administration debt restructuring program that the President announced about a year ago and has been gradually evolving since that time.

One of the notable provisions under which that program has been operating is that it would not be used to guarantee or restructure long-term land mortgages. That administrative decision was made deliberately to exclude the Federal Land Banks from access to that program because of the tremendous exposure that that would produce on the Farmers Home Administration. But that can be extended administratively if this administration wished to do so.

Now let's turn to new legislative initiatives that one might consider. Mr. Roberts mentioned the one that is at the top of my list, and that is to guarantee the securities of the Farm Credit System. Since Mr. Wilkinson's announcement, the very, very favorable borrowing costs of the Farm Credit System on Wall Street have changed. Where the differential between Treasury securities and Farm Credit System securities was less than a tenth of 1 percent prior to that announcement, it has now broadened to roughly three-quarters of 1 percent.

As an indication of where we may be headed, I think some of you understand that a couple of years ago, when there were serious difficulties in the savings and loan business in this country, the Fannie Mae issues, which are quite parallel in many respects to the Farm Credit System, that the borrowing cost spread opened up to 1.5 to 2 full percentage points. The last thing in the world that we can afford in the Farm Credit System is to have new borrowing costs on Wall Street increase 2 percentage points beyond what they are right now.

The way to address that problem is to make it very, very clear through a sense-of-the-Congress resolution or legislation that, by golly, this Government is going to stand behind those agency securities and not permit any defaults. I agree with Mr. Roberts that that is a matter of priority.

The second thing that we might do in regard to their bond offerings is to recognize that there exists out there is their portfolio a very substantial number of very high coupon bonds that they issued during the high interest period of a few years ago. There are $1.5 billion worth of those due to mature in the next year and several billions more due to mature in 1987 and beyond. Some of them go out to 20-year maturities but have very high coupon rates.

To give you an example, there is an 11.65-percent bond—that is the face interest value of that bond—that is due in January 1989. They are paying 11.6 percent on that piece of paper. It sells every day in New York right now for $102.20. That means $102.20 for $100 face value in bonds. One simple approach to congressional intervention in that market that would be helpful on their borrowing costs is for Congress to say, "Hey, we'll give you the $2.20. You put up the $100 and we will redeem that bond, and you can get your $100 back by going back into the market with a new issue and selling it at 7.5 percent instead of 11.5 percent." This is an extremely simple, effective way of doing it if we are willing to put up some upfront money. I would estimate that they could potentially redeem $5 billion of high-interest rate bonds by doing that.

A third thing in the way of new legislative initiatives involves establishment of a central reserve. One of the great flaws in the basic act, and blame has to be laid at the door of Congress many, many years ago, is the fact that we did not provide for a central reserve in that system. That is why the consolidations are going on. There have not been any funds in liquid form that the Governor had at his command that he could put at the points of crisis before it began to snowball. I think one of the things that we need to consider is to provide permanently, and on the short term perhaps, for the availability of such a central reserve.

Another possibility in terms of direct appropriations is interest subsidies. Now this can be applied in a variety of ways, and I am sure we will consider that. I think the members of this subcommittee recognize this.

Moving to some things that are more subtle that do not cost anything upfront but that are, at least in part, smoke and mirrors, one might consider something along this line: under the provisions of the act, the Farm Credit System is a very highly capitalized system. The act provides, for example, that in the intermediate banks and production credit associations they have to maintain capital accounts of 10 percent. The average capital account in the commercial banks in this country is 5.5 percent. The production credit associations are out of business when they are down to 10 cents on the dollar in capital. That is almost double the average capital requirements of commercial banks.

Something that would provide some time relief and that is not totally irresponsible would be to cut those capital requirements in half for a short period of time and require the farm credit institutions to gradually rebuild those over a period of years.

I would like to discuss other innovative types of financing arrangements by going back to the history of how this Congress attacked the problems of the savings and loans in this country. There was a great reluctance to put hard capital into those institutions. What we did, in our wisdom, was to essentially use funny money. We invented something called a net worth certificate. It was essentially a piece of paper that said that this piece of paper for all purposes of law is worth so much capital in the accounts of any savings and loan association in this country that is in trouble, and the regulator of that savings and loan has the power to issue this piece of paper. I think it would be a very interesting exercise to see how many of the savings and loans in this country at the present time are solvent only because of the presence of those pieces of paper in the capital accounts of those systems.

I happen to think that that proposal was totally irresponsible, primarily because no provision was made to get those capital certificates out of the system. That is the difficulty.

But one could use that concept in a much more responsible ~~manner~~ if ~~one~~ made them of limited time value; in other words, if they were forced to depreciate in value every month or every year, thereby buying time for that institution to make other more permanent, more responsible adjustments to put it on a sounder basis.

Next we come to the idea of creating a new Fannie Mae to serve as farm mortgages, just like Fannie Mae services housing mortgages. This has been mentioned this morning. The nickname that seems to evolve naturally is Aggie Mae or Agricultural Conservation Corporation. There are a great many variations on this, but the basic concept is somehow you get investors to finance these mortgages on the secondary market. The great difference between a Fannie Mae and an Aggie Mae is that Fannie Mae was set up to provide a secondary market in sound home mortgages and we are going to try to set up an Aggie Mae that will take over questionable farm mortgages. That is certainly going to imply, if you are going to get investors interested, very substantial Federal guarantees and somebody else besides those investors assuming the great share of the risk.

I know I have talked too long, but, finally, I would like to make one point that I think is extremely important. On this one I will take a position because I think it is essential to farm credit in this country in the years ahead.

I think that one of the great management mistakes of the Farm Credit System a few years ago was to decide that they were no longer going to issue fixed-rate, long-term farmland mortgages. So we have gone to variable rate mortgages in the Farm Credit System, and that is the root of the difficulties. Many of those borrowers out there who borrowed at 7 or 8 percent had no idea it could go to 14 percent, as it has, and that has been the final straw that has broken their backs.

I think we must in this subcommittee in some manner go back to making available in the Farm Credit System long-term, fixed-rate mortgages. I would say that the Farm Credit System, of all the lending institutions in this country, is in a unique position to be able to do that without imposing any risk on the borrowers or on the system, because they are uniquely able to go to Wall Street and borrow for a 20-year term or a 15-year term or a 10-year term and then to issue matching mortgages at a fixed rate for those periods of time without there being any risk to anyone other than the bondholder.

I am also of the view that that possibility probably should be extended to commercial banks. Money that the Farm Credit System borrowed on Wall Street should be made available for those types of fixed-rate mortgages through commercial banks because of the lack of confidence that exists at the present time in the Farm Credit System, at least in the Midwest.

I apologize to the chairman for taking that time and thank him very much for his courtesy.

[The prepared statement of Mr. Evans appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Evans. We appreciate your interest in farm credit and the support that you have given us on the subcommittee.

The next witness in line at the time the witnesses were called is the Honorable Tim Penny from the State of Minnesota.

Tim.

STATEMENT OF HON. TIMOTHY J. PENNY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MINNESOTA

Mr. PENNY. Thank you, Mr. Chairman.

I read an article recently that related Congressman Evans of Iowa as a recognized expert on farm credit. I think he just demonstrated that here this morning. He has given the subcommittee a long list of options that are available to us as we try to address the need to assist the Farm Credit System.

I want to, as well, endorse the remarks made by my colleague, Mr. Pat Roberts of Kansas, because he hit I think on some of the crucial issues that need to be addressed as we face this problem before your subcommittee and before the Congress.

In particular, I was glad to hear Mr. Roberts mention the problem of interest cost to our borrowers and his strong feeling that we simply cannot solve the Farm Credit System problem by allowing them to pass higher and higher interest costs onto their borrowers. In the long run that creates an even larger problem for the system because they will be pushing more and more borrowers into financial distress.

One solution that has been proposed, and it was mentioned earlier today by my colleague from Minnesota, Mr. Stangeland, is to adopt the proposal put forward by Communicating for Agriculture that is termed the Debt Adjustment Act. It has the number H.R. 2064. I cosponsored that measure with Mr. Stangeland. I think it is one approach that ought to be considered by this subcommittee as we try to address our farm credit needs.

The bottom line, though, is, we are in the mess we are because farmers don't have enough income. As you look at the problems of the Farm Credit System, I want you to talk carefully with the lenders and with the farmers involved so that you have a clear picture of where the system is today and where it is likely to be based on our projections for commodity prices and farm income over the next several months and years.

My guess is that, though the farm credit system now admits to severe financial difficulties, if you have current figures in hand, the difficulties are perhaps worse than they are admitting to.

I have a chart that I want handed out. It includes statistics on farm prices just in the last few months.

[The chart follows:]

TIMOTHY J. PENNY
1st District, Minnesota

COMMITTEES:
AGRICULTURE
VETERANS' AFFAIRS

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Washington, D.C. 20515

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Mankato, Minnesota 56001
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REDUCED FARM INCOME FOR MINNESOTA
from falling prices - July 9 / September 9

A. TYPICAL SOUTHEASTERN MINNESOTA SOYBEAN PRODUCER

Production Costs per Acre (without labor)	$209
July 9 price	$ 5.23 per bushel
Projected yield	34 bushels per acre
Income	$178
Loss	($31)per acre
September 9 price	$ 4.66 per bushel
Same yield, same expense	
Lower income	$158

Soybean production in S.E. Minnesota	983,005 acres
July 9 loss	($30.5 million)
September 9 loss	($50.1 million)

*Data Source: Division of Agricultural Education, University of Minnesota, and Minnesota Dept. of Agriculture, Statistical Reporting Service.

B. REDUCED INCOME STATEWIDE
for contractable commodities

COMMODITY		PRICE DECLINE	ESTIMATES OF 1985 PRODUCTION	LOST SALES
corn (per bushel)	July 9 / September 9	$2.10 1.83 -$ .27	721.5 M bu.	$194.8 M
beans (per bushel)		$5.23 4.66 -$ .57	174.8 M bu.	$99.6 M
hogs (per cwt.)		$48.50 38.00 -$10.50	(for 2 months) 248.1 M lbs.	$26.0 M
cattle (per cwt.)		$54.50 50.50 -$ 4.00	(for 2 months) 420.7 M lbs.	$16.8 M
milk (per cwt.)		$11.37 11.40 +$ 0.03	(for 2 months) 1,858 M lbs.	(+) $ 0.5 M

TOTAL REDUCED INCOME STATEWIDE JULY 9 TO SEPTEMBER 9 = $336.7 M

Mr. PENNY. Under example A, it shows a typical southeastern Minnesota soybean producer and indicates the cost of production for that producer and what kind of income they were receiving based on July 9 prices, July 9, 1985, and then it updates that to indicate the kind of income that they have based on September 9 prices, just 2 months later.

If you look at July 9, this producer in the example I have given had cash receipts of $178 while his production costs, not including labor, were $209 per acre, a loss of $31 per acre. You cannot service your debt when you are losing $31 per acre.

If you update that income to use the September 9 soybean price, you find that same farmer losing $51 per acre. His situation is eroding. That means our rural credit situation is also eroding. They are not going to be able to service their debt if that income continues to slide.

The second example I have given, example B, takes production statewide in all commodities and it indicates where that price was—what has happened to that price for each of those commodities from July 9 to September 9, and in each instance you have seen a dramatic decline.

In corn, in that 2-month time period there has been a 27-cent reduction in price. In beans, it has been a 57-cent reduction; in hogs, $10.50; in cattle, $4. Milk is the only place where there was a modest gain, but we know that under this administration that kind of gain is not likely to continue. It doesn't paint a very good picture for agriculture in our State or agriculture across the Nation when you see these kinds of prices.

All in all, in Minnesota these figures translate into a $336 million loss in income to our farmers in just the last 2 months, given the decline in their prices. As you look at a solution to the credit problem, keep in mind that with these continually decreasing farm prices, the problem for our Farm Credit System and our rural banks is growing worse by the day. As our farmers lose income, our credit system is going to lose its ability to stay anywhere near solvent. They will fall further and further into difficulty as the farmer falls further and further into debt.

The other concern is the approach we take that will address the long-term solvency of our Farm Credit System. Unless we change the income picture for farmers, anything we do now to prop up the system will only be a band-aid on a gaping wound. The solution that we propose must be a long-term remedy, and it must recognize the other side of the equation. That is something that your subcommittee cannot deal with. It is something we must deal with in the farm bill and in farm policy, and that is price for our commodities.

If we don't get the farmer the price, no amount of tinkering with the Farm Credit System or with debt adjustment to lower their interest rates, or any of the other schemes that have been proposed that might ease those interest rates on their existing debt, none of those solutions are going to solve our problem. Eventually we will slide even deeper into the abyss. I want you to be aware of that as you do your subcommittee's work because the farm income side of this equation certainly must be addressed or we are not going to save the Farm Credit System.

I don't want to see a package put forward that saves the system while we lose our farmers. I want us to remember that the bottom line in this subcommittee must be to save our farmers, and they in turn will save the system.

I thank you, Mr. Chairman, for your attention and wish you the best in your efforts to come to some remedy to a very serious problem that threatens to grow worse unless we in this Congress take appropriate action.

Mr. **JONES** of Tennessee. Thank you very much, Tim. We appreciate your statement and your support on this issue.

The next witness on the list at the time the witness list was open and was present is the Hon. Berkley Bedell.

Berk, we appreciate your being here. Congratulations on a good day yesterday. We miss you on this subcommittee, but we appreciate the fact that you have taken the time to be with us today.

STATEMENT OF HON. BERKLEY BEDELL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF IOWA

Mr. **BEDELL**. Thank you.

You know I am disappointed not to be on this subcommittee because I served for many years on it and it is such a great subcommittee.

I would like, first of all, to echo the statements of many of my colleagues in regard to this problem. I would particularly like to echo what Tim Penny just said, and that is that our real job is to keep the Farm Credit System alive while we save the farmers, so the farmers can save the Farm Credit System.

Because of what has already been said, Mr. Chairman, I would like to summarize and skip through my remarks and would request that my entire statement be made a part of the record.

Mr. **JONES** of Tennessee. Without objection, all the statements are going to be made a part of the record. I will ask for that at the close of the hearing.

Mr. **BEDELL**. Thank you.

The report recently released by the Farm Credit Administration on the condition and performance of the system for the quarter ending March 31, 1985, clearly shows that the seriousness of the System's difficulties matches that of its borrowers. In that report the FCA stated that nonperforming loans amounted to a startling 17.5 percent of total outstanding loans for the Federal intermediate credit banks, 14.9 percent for production credit associations, and 10.2 percent for the Federal land banks.

Mr. Chairman, as we look at this problem, I think we have to balance the needs of the System with the obligations that we have to reduce budget deficits. Certainly reducing deficits would lower interest rates, and that would help both our farmers and the System as well.

In the near term, however, because of the important role that the System plays in our agricultural economy and the important interrelationship that it has developed with our entire national economy, some form of additional assistance may be necessary. With between 10 and 15 percent of its current loans classified as nonperforming, Governor Wilkinson recently estimated that such Government assistance would be needed in 18 to 24 months.

However, in the course of this hearing and in the broader congressional debate on the type of Government assistance that should be provided to the Farm Credit System, I believe that there are several important points that must be considered. The first, and perhaps most obvious, is that Congress must carefully blance the needs of the System with its obligation to reduce our budget deficits. In this regard, the system must be required to utilize every resource at its disposal, such as loan-loss reserves, to meet its obligations if the Federal Government is to provide any financial assistance.

The second important consideration concerns the organization and management of the System. When the FCS was originally capitalized by the Federal Government, it sought to provide farmers with a reliable credit source within a member-owned cooperative that would encourage farm ownership. Now, as various proposals are brought before Congress to protect the financial integrity of the Farm Credit System, we must carefully weigh and measure them in regard to each of these original goals.

Unfortunately, within the System itself, it does not appear that such consideration is always given to these original goals. For instance, while the Nation's farm credit banks have moved to provide a package of financial assistance to the Omaha Intermediate Credit Bank, they have done so only with the understanding that the Omaha district reorganize itself to form one Production Credit Association [PCA] from its 37 local and separate PCA's and one Federal Land Bank Association [FLBA] from the 31 FLBA's.

As member-owned cooperatives, the whole foundation of organization and management in local PCA's and FLBA's has been and should continue to be built upon the input of the farmer borrower. This foundation of local autonomy has been increasingly undermined, though, in the past several months as coercive efforts have been made by the System's central authorities to streamline the FCS.

Indeed, a recent article in the Des Moines Register quoted the chairman of the committee that developed the Omaha Financial Assistance Plan as saying: "If you vote reorganization down, it means you don't want assistance." That means, he went on to say, that the Omaha district borrowers would have voted to liquidate their local associations if they did not vote for the reorganization that they were proposing. It seems to me that that type of coercive take-it-or-leave-it attitude is not the type of attitude that we need to have in the Farm Credit System if it is really going to represent the local farmers.

Another point I think we need to consider in reviewing any proposal to assist the Farm Credit System concerns its effects on the individual borrower. While we must protect the financial integrity of the System, this was really set up to be a help to farmers. I believe that we have to give that some consideration, rather than solely the consideration of what they call their bondholders.

As I have talked with them over problems, they don't talk about the farmers. All they talk about is their bondholders, Mr. Chairman. I think it is incumbent upon us to look at those problems.

I have quite a little more in my statement but, in the interest of time, I will conclude there.

I certainly commend your subcommittee and wish you well as you address this problem.

[The prepared statement of Mr. Bedell appears at the conclusion of the hearing.]

Mr. Jones of Tennessee. Thank you very much, Berk.

May I emphasize the fact that we do appreciate the concern that you have had for the Farm Credit System as well as other problems in this subcommittee that we have to face from time to time.

The next Member to be called is the Honorable Ron Marlenee from the State of Montana.

Ron, we are delighted to have you.

STATEMENT OF HON. RON MARLENEE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MONTANA

Mr. Marlenee. Thank you, Mr. Chairman.

Without reiterating all the rhetoric that has heretofore been presented, let me say that the position of jeopardy that the Farm Credit System is in is the result of years of selling products at prices that are below the cost of production and then going to the lender and financing that cheap food policy.

The greatest transfer of wealth the world has ever seen is occurring, and this farm credit crisis is the final damning piece of evidence that this is so.

In my opinion, at this time, we have two options. One, we either address this problem in a nonpartisan, cooperative spirit or, two, within 6 to 8 months we will see the damnedest crash in real estate values that this Nation has ever experienced. It will make the slide in the thirties look like a mere adjustment.

I would call on this committee, the Senate, the administration, the Farm Credit Administration, the Federal Reserve, and the Farm Credit System, and representatives of both the American Bankers Association and the Independent Bankers Association to sit down and—without partisanship or pride of authorship—put into place actions which reestablish the confidence in the Farm Credit System.

First, I am introducing a sense-of-Congress resolution that a special blue ribbon panel that embraces the bodies of jurisdiction in farm financing be created. I think that is absolutely essential. I think we should get on with that immediately under the leadership of the White House.

Second, Congress, the Farm Credit System, and the administration should establish that the bonds are and will continue to be premium instruments. The result of this would be that these instruments would receive interest-rate considerations that are premium.

Third, the establishment and support of an entity to handle those loans that cannot be restructured. This cooperatively should be undertaken by the Farm Credit Administration, by the Congress, by the U.S. Government, by the administration.

The result of this serves two purposes: One, it frees up and unburdens the system and other borrowers from having to carry the paper that is nonperforming and, two, it keeps real estate from being dumped on the market and further depressing real estate markets.

Some vehicle should be sought to directly lower interest rates to the whole sector of the agriculture community. A 1-percent rate decrease in interest rates translates into a 10 percent increase in net farm income. Now one way to do this would be through the issuance of a one-time bond issue that had tax incentives for the buyer—much the same as school bonds or municipal bonds. But I think it is imperative that we see at least for 1, perhaps 2 years a decrease by a significant amount, a point or more, a decrease in the interest rate of 1 percent or more.

There are a good number of farms and producers who are good operators and, although they are struggling, they are meeting their obligations. The long-term credit that they use is the most important factor in their management equation.

If we can protect that factor, protect long-term credit, improve their income, which we are attempting to do with the recent farm bill, ease their interest rate, and stabilize real estate values to stop this slide in real estate values that is going on, we will do a service to all of America, to say nothing of agriculture.

The problem is not unsolvable. The only obstacle I think would be the obstinacy of any one group, and that is why I would like to see a blue ribbon panel put together—and put together immediately—to iron out some of these differences and rhetoric that we see going on in the news media.

When we look at the picture of what we can do, we can pick out a lot of things that should be considered that are positive and should help to modify the panic and paranoia. Farmers should get—and I will venture to say will get—credit for their operations next year. The bottom line of that prediction is, Mr. Chairman, that with the guaranteed lender program you could have long-term guarantees whereby the commercial banks—and I have had a number of commercial banks propose this to me—could underwrite a majority of the long-term credit. Now I think it would require Congress to modify the higher loan limits, put into place higher loan limits, and a couple of slight modifications, but we could assure all of the agricultural sector through the guaranteed lenders program that, if the Farm Credit System hit the worst-case scenario, that there would, indeed, be long-term credit available even if ballooning interest rates should take farm credit out of the picture. This would serve as an interim until we could get the farm credit put back on line.

In closing, Mr. Chairman, again I say long-term credit is the most important factor in the management equation. It is the most important tool a producer must deal with. We must act on this even if it requires special sessions or long sessions—not to act could bring chaos that will spread to all of America, but to act in time means stability not only for producers, but for America.

I thank you, Mr. Chairman. I miss being on your subcommittee.

[The prepared statement of Mr. Marlenee appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Ron. We do miss you, too—I must tell you that—very much. We do appreciate the very fine statement that you made. It has some very good points. Without a doubt, the subcommittee will give it some real consideration.

Our next witness is a graduate of the House Committee on Agriculture, the Subcommittee on Conservation, Credit, and Rural Development, and of the House of Representatives. Congressman Tom Harkin was a very valued member of this committee and this House until he chose to move over to the other side.

Tom, I am sure that you are going to do a plus-job there the same as you did here. We appreciate you very much.

I apologize for the fact that you had to wait awhile, but you understand the House procedure and the customs here that we follow. This subcommittee chairman is not going to change those customs; he is going to follow them even for you.

I appreciate very much the fact that you have taken the time to come and return. You may take whatever time that is necessary.

STATEMENT OF HON. TOM HARKIN, A U.S. SENATOR FROM THE STATE OF IOWA

Senator HARKIN. Mr. Chairman, thank you for that kind introduction.

I have some very strong personal feelings about this subcommittee, as you know. As you said, I served on this subcommittee for 8 of my 10 years here in Congress under your distinguished and able leadership on this subcommittee. We fought many battles. I think we did a lot of good things in the past in solving credit problems as they came up in the past, and, as you know, Mr. Chairman, things are not static; they change over periods of time. So we have to address the new problems as they arise in our society.

I want to congratulate you, Mr. Chairman, for your long service not only in the House of Representatives, but for your total dedication to the service of American agriculture over your entire lifetime, and especially on this committee, and more especially on this subcommittee. I think it goes without saying that were it not for Congressman Ed Jones of Tennessee, American agriculture would be in even worse shape than it is now and that the credit problems the farmers are facing would be in even more dire straits, were it not for the leadership of Ed Jones of Tennessee.

Mr. Chairman, I am honored to be back here today. I just wish that I could be back under different circumstances. In fact, I wish we didn't even have to have the hearing.

I don't mean to belabor it for too long. I am sure all of the points that other members had—and to those members, I apologize for having to leave. We have a credit markup in our own Senate Agriculture Committee today, and so I have to leave to go over there for a couple of votes.

Mr. Chairman and members of this subcommittee, as I said, things are getting bad. They are bad; they are getting worse. We have two problems in agriculture. Again, I don't mean to belabor them: a loss of real income and falling land prices. In Iowa, we have had a fall of over 49 percent in our land prices since 1981.

The root problem, as we all know, is that there is no income, but there are steps that we can take right now to stabilize land prices.

We can do it by using a technical means called the income capitalization method. It is used widely now by 17 States. Seventeen States use it to figure their property taxes. In fact, the Farm Credit System used this from its inception back in the 1930's until 1971. They used the income capitalization method to evaluate the basis for their loans up to 1971, and in 1971 they went off of it. I will have more to say about that in a minute.

Mr. Chairman, we did a survey in Iowa earlier this summer. I had this chart made not just for this specific subcommittee but for some hearings I had in Iowa. We did a study of 31 farms in 4 counties, 4 counties that represent various types of yield productive factors in the State of Iowa. Of the 31 farms that we surveyed—these were all farms that sold since January 1 of this year; every one of them was actual sales—26 of those 31 farms sold for less than the income capitalization value.

This chart represents just four farms in four different counties, one farm in each county. The yellow line, Mr. Chairman, indicates what that farm sold for or what it was worth and evaluated at in 1981. That is the yellow line for each one of these farms.

The red line indicates what it actually sold for since January 1 of this year. The blue line represents the income capitalization value of that specific farm.

I think what this chart shows is that, No. 1, probably without a doubt, farmers paid too much for this land. It wasn't worth that much in terms of how much it could return to capital. On the other hand, it is now selling for less than what it can produce and it is going lower every day.

By using the income capitalization formula, we can not only stabilize land prices, but I think even shore them up and bring them up a little bit. I think that chart demonstrates it quite well.

Now there have been a couple of alternatives proposed with this credit situation. First, one alternative was to form a quasi-public-private entity, like an Aggie Mae, that would take ownership of the land. They would hold the land for periods of 5 to 10 years and then they would sell it back. I ask the rhetorical question, "Sell it back to whom?" Are they going to take thousands and thousands of acres and put into their portfolio? I might add they are also going to take title to that land. Are they then going to want to sell it back in 100-acre, 200-acre parcels? I think not. They are going to want to sell it in big chunks, 5,000 acres or more, to whoever the highest bidder might be at that time.

The second alternative was just to put an amount of money, say $5 billion, into the Farm Credit System. The Farm Credit System would then use a newly formed corporation that they have come up with to purchase nonperforming loans and then to go ahead and liquidate them. Again, I ask the rhetorical question, "Should we be using taxpayers' moneys to finance and fund the liquidation of some of these loans?" I hope not.

Mr. Chairman, both of these proposals I think are bad for farmers. No. 1, it separates them from their land. It takes title away from them.

Second, it further promotes the devaluation and decline in farmland values.

Third, the latter proposal, just putting money into the Farm Credit System, does not really deal with loans in private banks or the lending institutions.

I think there are at least five criteria that we should follow in trying to get out of this credit mess we are in and in trying to stabilize land values.

The first criterion is, No. 1, that we ought to stabilize land prices. We should prevent the Farm Credit System, banks, and regulators from devaluing land below its income-producing value. Certainly $4,000-an-acre land in Iowa 4 or 5 years ago was too high, but that same land selling for $1,000 an acre now is too low. The regulators and others are pushing down the prices of those lands.

The second criterion that I think we ought to use is that our first priority ought to be to directly aid farmers, not just bondholders, not just the lending institutions, but our first priority ought to be to directly aid farmers.

The third criterion is that we should not require farmers to give up title to their land. We should insist that farmers keep title.

The fourth criterion, we should not limit assistance just to borrowers of the Farm Credit System. We must recognize the banks' problems and other lending institution problems.

The fifth criterion I think, Mr. Chairman, and perhaps the most salient of all, is that all parties—the Government, the lending institution, and the farmer—who all contributed to the problem in one way or another, all of them should be required to contribute to the solution.

Mr. Chairman, the solution, I think using these five criteria, using existing data, using the income capitalization formulas embodied in the bill S. 1340—what this bill basically does is it requires the Farmers Home Administration, the Farm Credit System, and federally chartered banks to use the income capitalization formula to determine the collateral value of farmland, not just to go out and say, "What is a neighboring farm selling for," but to use the income capitalization formula to determine the collateral value.

In the case of the Farm Credit System, this would simply be having them go back to using the same kind of formula they used prior to 1971. Members of the subcommittee have a sheet of paper that I had with my testimony. It says, "Provisions of S. 1340." That is the title of it. On the back is an example using the income capitalization formula and how that would operate. I won't walk through that.

I would just say that we used this formula to determine the figures we had on this chart. I might also point out that the Soil Conservation Service has all of this in computers right now anyway. So it is very easy for them to program it.

Let me just walk quickly through one example of how this would work. Let's say we have a farmer who borrowed $150,000 from the Federal land bank, a 30-year loan. Let's say over the intervening few years he has paid $15,000. He has $135,000 left on his note. He misses a payment. The Farm Credit System calls the note.

They have looked around and they have found that the present selling price of land of the same type in the same vicinity is selling for $90,000, for that same type of a parcel of land. The farmer owes

$135,000. The present selling price of land is $90,000. Using the income capitalization formula, the value of the land actually comes out at $110,000. Well, here's what would happen:

The farmer who has been told by the Federal land bank to pay up his note or they are going to foreclose would then go to Farmers Home Administration. The Farmers Home Administration would loan that farmer basically up to the income capitalization value of the land or $110,000. In effect, the Farmers Home Administration would be purchasing from the Farm Credit System that note for the income capitalization value of the land.

Now if the Farm Credit System decided they didn't want to do that but they were going to go ahead and proceed with the foreclosure, then Farmers Home Administration would go to the farmer and say, "OK, we'll loan you the $110,000 and you can go bid on your own land when it comes up for sale."

I tend to think that if they foreclose and they go to sale that farmers in that neighborhood are not going to try to outbid the owner of that property that was put off of it.

What happens here is that the Farm Credit System gives up something. They give up $25,000. In other words, there was $135,000 on the note but we are buying it from them for $110,000. They have to write off $25,000. Now that's tough, but if they went ahead and foreclosed and sold the land, the most they are going to get for it is $90,000. So they are $20,000 better off than they would be if they went ahead and foreclosed.

The farmer gives up something. Under the bill that we have proposed the farmer would give up all nonagricultural rights for up to 40 years. In other words, that farmer could not use that land for anything other than agricultural purposes for up to 40 years; couldn't sell it for a shopping center development or something like that.

The Government, what did it give up? Well, we have to make the loans and we have to service the loans and pay the administrative costs. Each entity actually gives up something. All three contribute to the solution.

I guess my summary points are this:

No. 1, we are in a landslide. We have to stop it. This kind of approach will do it. It won't set the value of land, but it will put a kind of floor—not a concrete floor but a floor out there.

There will be some people who will buy it for more and some who will sell it for less, depending upon other circumstances, but at least we will know what the collateral value is.

Second, farmland value is not what it brings at a fire sale but the value of the farmland is what it will return in capital over a longer period of time.

Third, there are potential buyers out there. I know of some myself who are waiting, who want to buy farmland right now, but they are not going to buy it because they think it is going to go lower.

You do something like this, and they know it is not going to go any lower than that, and they are going to have to get in and start buying. That, I think, will tend to shore up the prices.

Last, Mr. Chairman, we are not setting the selling price, only the collateral value of the farmland over a longer period of time. As I said, for specific reasons, there may be some who might want to pay more and some who might want to sell it for less, but at least we would stop the landslide.

I would just close with this, Mr. Chairman: there is not too much new under the sun. We went through this whole thing, figuring this whole thing out, staff work, the income capitalization formula, and everything—only to find out that it has been done before and it worked. In 1933, when the then-Roosevelt administration came in, they wanted to do two things. They wanted to shore up farm income and they wanted to stop the slide in land prices. The first thing they did was to stop the slide in land prices. That administration set up the Farm Credit Administration.

Here is what they did: they went out and they just arbitrarily—not as accurate as this because now we have the data in the Soil Conservation Service—they just said that, "OK, Farmer Jones, your farmland now is worth what it would be worth if your crops were selling for what crops sold for during the 1910–14 period. The Government will loan you money up to that value on your land."

That happened in 1933. It stopped immediately the slide in land prices. From that year on, land prices started going up completely, even throughout the depression years.

Then they came in later and tried to do something about the income level of farmers. It is similar to this. They didn't have the income capitalization formula. They didn't have all the land surveys. They didn't know the productive factors of the farmland. It was a very crude method, but, even as crude as it was, it worked. We have the data right now to make this work and, if we would use the income capitalization formula, we could do those things.

I would be glad to try to answer any questions that you or any member might have, Mr. Chairman.

[The prepared statement of Senator Harkin appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Tom, for a very good statement, and a statement that, no doubt, this subcommittee can refer to and use as we proceed to correct some of the problems of the Farm Credit System.

We appreciate the time that you have spent here. We may be in touch with you about some of the things that you have in your statement today.

Senator HARKIN. Thank you very much, Mr. Chairman.

Mr. JONES of Tennessee. Thank you.

Our next witness is also a former Member of the House of Representatives and also a member of the Committee on Agriculture here in the House. Senator Grassley chose to leave the House and also graduate and move over to the other body. He is very active there on the committee as he was here.

Chuck, we are delighted that you would take the time to come here. We have followed the hearings that you have had in your State. We are aware of the problems that you have in Iowa. We have members on this subcommittee who are very cognizant of the problems out there, and they keep us abreast of the problems. We probably know as much about the State of Iowa's economic conditions agriculturally speaking as we do any State in the Union.

We appreciate the time and the interest that you would take to come here today.

You may proceed with whatever statement you have.

STATEMENT OF HON. CHARLES GRASSLEY, A U.S. SENATOR FROM THE STATE OF IOWA

Senator **Grassley**. Thank you, Chairman Jones.

Let me say that I appreciated my 6 years on the committee working with you and find you now continuing the leadership role you have always played in agriculture.

I would take up, Mr. Chairman, where you just left off, where you mentioned that you had heard about the hearing I held in the State of Iowa. That hearing lasted 9 hours, and we covered lots of territory. I would like to share with you some observations from that hearing.

First, farmer-stockholders as well as past and present board members and professional managers of the Farm Credit System expressed serious concern at that hearing that they have been kept in the dark about what the Farm Credit System is doing; that they have been offered ultimatums, not alternatives; and that effective control of this cooperative lending institution has been taken away from them at the grassroots level. Remember, it was set up to serve farmers and to be controlled by the farmer-stockholder members.

I think you only need to look at Project 1995 to realize that the top layer of professional managers of the Farm Credit System has the goal of centralizing more control into their own hands and away from the grassroots. It is my conclusion and the conclusion of people who heard the hearing that we cannot let this happen.

The second point that seemed to be underscored by my hearing is that, regardless of what we do in Washington during the months ahead to help bolster the financial condition of the Farm Credit System, the professional managers of the system intend to move full steam ahead with its reorganization and its bailout plan. These officials will tell us that they have no choice. I am not so certain, nor do I believe Congress can afford to accept their position.

The reason is that their bailout plan involves what appears to amount to massive farm liquidations in States such as Iowa and Nebraska, which can least afford large scale disruption. The Farm Credit System has set up a capital corporation which will take over what they have decided to be high risk assets, but the formula used to determine what is defined as high risk loan appears to be severely skewed to push loan values down to unrealistic levels.

For instance, I was informed by one official that the loan formula does not give credit for Farmers Home Administration loan guarantees. If this is true, a farmer could have a 90-percent loan guarantee and still be thrown into the high risk category, and thus end up in the hands of the capital corporation.

The point here, however, is that the lower the value placed on these loans, the larger the number of liquidations that will occur.

Farm credit officials said they had no estimates of the number to be liquidated. I have heard that as high as 25 to 30 percent of the Federal intermediate credit bank and the Production Credit Association loans in the Eighth District could be liquidated. This would bring tremendous suffering among farmers and would devastate our economy. I think it would bring to certainty what we have heard of the tremendous restructuring that is going to go on in agriculture.

At the close of the hearing I made it clear that I was unwilling to write a blank check for any kind of Government bailout until I see dramatic improvement in the treatment of our farmers.

In short, we may need to seek means to put the system's plan of action on hold until Congress has the time to work out an assistance package. It seems Congress should also seek means of returning control back into the hands of the farmer-stockholders. We should also explore the means for stronger regulation. Let me make clear that these two recommendations are not incompatible. We no more need to centralize the power of the Farm Credit System than we need to consolidate our Nation's banks into one bank under the FDIC. If anything, the Farm Credit System, which controls 35 to 40 percent of America's agricultural loans, already has too much power left in the hands of its top layer of professional managers.

Congress needs to explore the possibility of creating a separate holding company, out of the control of the system, which would take over high risk loans but, unlike the system, this entity would work with the farmers as much as possible to keep him in business, instead of liquidating him, "from the system as soon as possible."

Another solution may be to offer Government assistance in buying down interest rates. Farmers testified at my hearing who said that they were doing fine until the Federal Land Bank raised their interest rates three-quarters of 1 percent. There are a good number of options to study, but I believe that it will be all for naught if we don't first put a hold on the system's present plans. The economies of the four States of the eighth district cannot afford mass liquidation. You can be certain that damage will not be limited to our borders. The depressing effect will spread like fire throughout the Midwest and other parts of the country.

Section 2001 of title 12 of the U.S. Code annotated clearly spells out congressional objections and policies with regard to the Farm Credit System. It clearly states that the system was established to serve farmers and be operated as a cooperative by farmers. We have to make certain that it continues to meet these objectives.

Let me, in closing, just emphasize that the system we are talking about today has one-third of all farm debt in the country. By any measure of impact upon the economy, that segment of lending to agriculture does have monopolistic position within farm credit. They do have the power to deliver on what we thought was just a mere suggestion that there is a restructuring of agriculture going to go on. They have the authority to deliver that.

There is a snowball rolling down the hill now that started several months ago, and it will be up to Congress to stop that snowball rolling down that hill, because while we might debate what should be done, there is already set in motion within the Farm Credit System the machinery for accomplishing the goal of liquidating 25 to 30 percent of their borrowers, and that is going to dictate the restructuring of agriculture that we have told will take place.

It is one thing to accept this as a fact of economic forces. It is another thing, though, to have the people who are either in governmental positions or quasi-governmental positions to stand by and either let that happen or actually promote it.

I say that while we work to accomplish our goal of solving the problems of the Farm Credit System, we must also stop that snowball from rolling.

Thank you, Mr. Chairman.

[The prepared statement of Senator Grassley appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Senator Grassley, for a good statement and for the dedicated work that you are doing for agriculture.

I would like to announce at this time that there will be no break for lunch.

The Honorable Bill Schuette, a member of the committee, will be the next witness to be heard. Then we will hear the Honorable Virginia Smith, and then the Honorable Ike Skelton, in that order.

Bill, we are delighted that you could take the time to be here. You may proceed.

STATEMENT OF HON. BILL SCHUETTE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN

Mr. SCHUETTE. Thank you, Chairman Jones.

Mr. JONES of Tennessee. Before you begin, Bill, may I say that there is one more U.S. Senator on the list, Senator Gary Hart, but he has announced that he cannot be here. He is submitting a statement for the record.

[The prepared statement of Senator Hart appears at the conclusion of the hearing.]

Mr. SCHUETTE. Thank you again, Mr. Jones. I appreciate your courtesy and cooperation this morning.

I appreciate the opportunity to testify before you today as the subcommittee continues to assess the present condition of the Farm Credit System and the options open to Congress to address its financial problems.

I also want to commend you, Chairman Jones, on your leadership on this issue and taking the initiative to set these hearings, to build a record, and so that our committee, and Congress as well, attends to these severe problems impacting agriculture.

I also want to thank my colleagues on the Agriculture Committee and visiting Congressmen and Congresswomen for being here today.

Now every one of us wishes that the circumstances were such that this hearing was not necessary. However, the financial condition of the system, highlighted by the Farm Credit Administration Governor Donald Wilkinson's recent remarks, make today's hearing of paramount importance.

There is an old saying among Michigan farmers that if you borrow $1,000 from the bank and can't pay it back, even though you want to, you're in trouble. But if you borrow $1 million and can't pay it back, even though you want to, the bank's in trouble.

Well, we are learning today that when you borrow miltibillions of dollars and you are unable to pay it back, even though you want to, our country, America, is in trouble.

The administrators of the Farm Credit System have long maintained that the system has the financial resources to take care of its own problems. However, this assertion is based upon two fundamental assumptions: No. 1, that the agricultural economy will continue to support the system, and the second is that the system will continue to quickly consolidate its capital.

Obviously, the first of these assumptions is questionable at best. Unfortunately, the farm economy continues to deteriorate. Land values are down 60 percent in many areas. As the farm economy slides, the Farm Credit System loses its ability to function.

May I stress at this point that we are not considering farm credit in a vacuum. The Farm Credit System of the United States is intimately tied to the farm economy as a whole. It is not just the Farm Credit System; it is agricultural commerical banks, tightly a part of the fabric of rural America, that is under great stress today. The troubles of the system today are symptomatic of the larger problem, the depression on America's farms.

We have no time to assess blame for the system's woes, and I don't intend to do so. Congress is as culpable as anyone for creating a system without the ability to move cash reserves around when and where necessary, and for not establishing annual outside audits. By permitting loans of up to 97 cents on the dollar, Congress helped to set the stage for large numbers of defaulted loans.

And the Farm Credit Administration can be rightfully criticized in a constructive way and in a constructive manner for many of its management practices, including loans that were highly questionable.

These practices, and others, have helped to create the situation faced by the system today. We have all heard the frightening statistics, but they cannot be repeated too often: as much as 15 percent of the system's $74 billion in loans may be uncollectible. System loans went from $20 billion in 1972 to $66.2 billion in 1980. At least 9 of the system's 37 main banks with more problem loans than they have capital. As much as half of the commercial farm debt in this country may be uncollectible.

Land values—the collateral underpinning most farm debt—continue to slide, eroding up to half the backing of loans in some parts of the country. I know it is affecting my district and the 10th District of Michigan.

And it comes as no news to this committee that the bin-busting harvest expected this fall will continue to push prices downward, unfortunately.

The many farm bankruptcies that result from the farm depression put more land on the market, driving down farm real estate values further, and thus eroding more land collateral, which puts even more farmers in trouble and in great jeopardy.

We must find solutions to this vicious spiral. To fail to do so threatens the very survival of American agriculture.

Now there are some actions the Government can take that will require very little budgetary outlay. For one, it can require the system to use its billion dollar reserves to help cover losses.

As my good friend from Iowa, Congressman Cooper Evans, has advocated, the Farmers Home Administration should broaden its debt restructuring program to include land mortgages.

Congress should immediately initiate annual outside audits of the FCA and provide for periodic audits of the system by the General Accounting Office.

The capital level requirement for Farm Credit System institutions is very high when compared to banks. We should examine the merits of reducing the requirement to a level more consistent and comparable with other lending institutions.

Congress could authorize new FCS long-term bond issues, to be used for fixed-rate, long-term mortgages.

H.R. 3231, introduced by Congressman Cooper Evans, should be enacted into law. It places the full faith and credit of the U.S. Government behind FCS bonds and thus would help to shore up investor confidence. I am pleased to be an original cosponsor of this important bill.

The Farm Credit System itself has proposed major changes, including new regulatory powers to issue cease and desist orders, to levy civil penalties, and to remove officers and directors of system banks. Even the creation of a new financial structure has been proposed, and we should carefully consider and carefully examine this option.

Mr. Chairman, we cannot ignore the problems of the Farm Credit System, for they are also the problems of the American farmer, and thus the problem of every single American in this great land. By taking action now, I am confident we can restore the system to sound health and maintain investor confidence without massive infusions of tax dollars.

I urge this subcommittee to carefully consider the available options and to prudently, which I am confident you will with your leadership, Mr. Jones, but without delay, maintain this vital source of capital for American farmers.

Let me say the sooner the better, because delay only means further hardship to people. Delay only means further hardship to farm families and people's lives.

We are not just talking about throwing money at a problem. The real problem this country is facing in rural America is price. If we had a better price, a fairer price for the product we grow better than any nation on this Earth, we wouldn't be facing the credit-income squeeze we are in right now.

Truly, as you know, Mr. Chairman, it is an income problem. It is a price problem. But in this intermediate stage and fashion, we must take all immediate and prudent, proper steps to shore up the system.

Let me just say, in closing, that I am honored that there is a constituent from my district, a gentleman named Larry De Vuyst from Ithaca, MI, who is soon to be appointed to the Federal Farm Credit Board. I am honored that we have another voice from mid-Michigan helping farmers. I think he will provide greater leadership to that institution.

Mr. Chairman, again, I thank you for the opportunity to be here this morning.

[The prepared statement of Mr. Schuette appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Bill Schuette, for a good statement. We do appreciate the splendid cooperation that we always receive from you.

Mr. SCHUETTE. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. The next witness, as has been announced already, is the Honorable Virginia Smith from the State of Nebraska.

Virginia, may I apologize to you for having to wait this long, but, as I announced earlier, the custom of the committee has been for a long, long time to take the immediate members of the House Committee on Agriculture first, and we had a lot of them today. I know your dedication to agriculture, the problems that your great State faces and is in the midst of, and your concern for the problem.

With that, we will be glad to hear from you.

STATEMENT OF HON. VIRGINIA SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEBRASKA

Mrs. SMITH. Thank you very much, Mr. Chairman.

I want to express my appreciation to all of you for holding this hearing. With the study and with the expertise in your subcommittee, including Mr. Evans' outstanding knowledge, and all the other Members of Congress and others who are testifying today, we should be able to come up with an answer to what is the most devastating problem that has faced agriculture in any of our lifetimes.

I have been spending months studying this issue, Mr. Chairman. It is very difficult to find out what the situation really is. There were many months of public assertion on the part of the Farm Credit System that everything was well. Then they suddenly came to the Congress and to the administration and they wanted help. It is essential not only that the farmers understand what is going on, but that the Congress have a chance to understand before we have to legislate. This hearing is very appropriate.

I have three suggestions.

First, I think we should consider the enactment of legislation designed to place the Farm Credit System under the same requirements as other federally-regulated lending institutions, especially with respect to the requirements for providing accurate and adequate information.

Second, I would like to call for the congressional blessing, perhaps in the form of a sense-of-Congress resolution, that the Federal Reserve start monitoring this system very closely and very carefully, and that it use its power to intercede with appropriate action, if necessary, and not too little and too late.

Third, on July 17, of this year I submitted a concurrent resolution which has been referred to the Committee on Agriculture. It expresses the sense of Congress in opposition to wresting local control from the farmer-owned and farmer-controlled Farm Credit System. House Concurrent Resolution 177 is still open for more cosponsors.

I am hoping that your distinguished subcommittee can obtain the answers to some very key questions.

First, what can be done to lower interest rates? If the Federal land bank cannot offer competitive interest rates by the next lending season, then it is not serving farmers, and that is the purpose for which it was established.

Mr. Chairman, I cannot answer the questions that my constituents are asking, like: "How does it happen that I can borrow money to buy a new car for 7.5 percent but the Federal land bank has raised the interest rate twice in 1 year to 13.5 percent?" That has to be changed.

I hope we can find the answer to the question, "Do we really need the PCA's any more?" Now that the Farmers Home Administration guaranteed program is being accepted by the banks, we ought to consider that.

Third, do we turn to the taxpayers for an infusion of funds? If so, do we make that available only to the Farm Credit System or to the rural banks that were more responsible lenders in the first place, or do we lower the value of the bonds that people have bought? If we do that, then what happens to our source of funding in this system? Or do we force the Farm Credit System to use, to the maximum safe level, its own reserves?

Then my fourth point: How are we going to change this system so that we reduce the danger of getting in this predicament again?

Mr. Chairman, I come from the second most agricultural congressional district in the Nation. I come from the hardest-hit agricultural district in the Nation. We have the largest debt-to-asset ratio of any State. We had this year in part of my district the worst drought in 80 years. We have had the worst grasshopper infestation in 30 years. The price of fed cattle has gone down 25 percent in the last year. Producers are losing an average of $150 a head on every fed animal that we sell. In my district there are 11 head of cattle for every person. The corn is below $2 for fall delivery in many areas. The crop is beautiful, but the pressure is going to be on for lower prices.

We have had more bank foreclosures this year than since the 1930's, more farm foreclosures than since the 1930's. In fact, in Nebraska one farmer goes out of business every hour, 20 farmers out of business a day. We have had the biggest deterioration of land values in the history of our State.

Now a couple of more points about the Farm Credit System. We have to be able to get better information. We are advised that they are required to have twice as much—almost twice as much—reserve capital as the commercial banks are required to have. Yet, spokesmen from the system say that they have only $2 billion or $3 billion that would be available to cover losses. Others assert that they could tap reserves of $6 billion. We are also told that they have $4.2 billion of liquid reserves that could be tapped within a week. We have not been able to find out what the accurate situation is.

It is for those reasons that I asked for an expedited GAO audit, because we need to know the facts. That report is going to soon be available to us. Already, financial information has been disclosed for the system showing several inherent weaknesses.

I have some reservations as to the quality of the financial data that is received by the Farm Credit Administration. My information shows that 12 active PCA's in the Omaha district had no reserves for loan losses although they definitely had a large number of problem loans. Even if they did have a provision for loan losses, the losses themselves were grossly understated.

Other information points to associations that have failed to even file a report. My information further is that on June 30, 1985, their financial data does not reflect the financial difficulties that have been identified during the special credit review of the Omaha PCA's. I question whether an organization of this magnitude can be fair to its owners, to its investors, or to the taxpayers of this country by not providing prompt and accurate information consistent with good business and good management practices.

There is a most serious loss of confidence in this whole system in the Midwest. The stockholders resent very bitterly that they are being coerced, as Senator Grassley pointed out, into agreeing to a liquidation and to loss of local control. They also resent the fact that in years past the employees of the Farm Credit Administration have urged that they take loans, have urged marginal farmers to invest in expensive irrigation equipment and land investment practices that were a recipe for disaster. In fact, some loans have been approved without verification of adequate collateral and loans for purposes rather than agriculture.

In conclusion, any solution that addresses this problem is going to have to stabilize the Farm Credit System. It is going to have to lower interest rates to competitive levels or the system will not be serving its purpose. We need to try to provide a vehicle to assist people who are very heavily in debt, and we must reduce the risk of this happening again. I am hopeful that your distinguished subcommittee can also address this matter with a separate piece of legislation and not as a part of the farm bill.

Thank you again very, very much.

[The prepared statement of Mrs. Smith appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Virginia, for a very splendid statement.

I want you to know that this subcommittee chairman is certainly in sympathy with the problems that you face in your State. I know that you feel that the entire country has a problem that is almost insurmountable at the present time.

We will be taking into consideration very seriously your statement and what you advocate and recommend.

Mrs. SMITH. Thank you very much.

Mr. JONES of Tennessee. We appreciate your being here and the time that you have devoted to the business of agriculture.

The next witness is the Honorable Ike Skelton from the State of Missouri. Ike is a very valued Member of the House of Representatives. He comes from a very fine agricultural State and is serving as chairman of the Congressional Rural Caucus and doing a very splendid job.

Ike, I want to congratulate you for taking the time out to be here with us today. I apologize for the length of time that you have had to wait, but we will be glad to hear from you at the present time.

STATEMENT OF HON. IKE SKELTON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MISSOURI

Mr. SKELTON. Mr. Chairman, all good things come to those who wait. I not only have had the benefit to hear your comments while waiting, but hearing the excellent statements by those that preceded me.

Mr. Chairman, as you know, I appear today as the chairman of the Congressional Rural Caucus. As such, I have two reports and some information I bring to you as a result of the work that our caucus has done.

But, first, let me for a moment digress and tell you, as other Members, we have been back to the district during the recess and have talked to the people that we represent. While I was there I went to a small community known as Tipton, which is in the north central part of my district. Tipton, MO, is basically a typical, rural community. In talking with my friends there, I learned of the agricultural plight in the whole area and the effect it is having on the community itself.

The elevator is closed down. Small businesses, one after another, are either in trouble or closing down. The local factory, because of nonfarm problems, has cut back in its work.

Mr. Chairman, rural and small town America is withering away. It is up to us to do what we can to stem the tide and to turn it around.

We all know that what the American farmer needs is a decent profit. They cannot continue to work as they are and lose money, lose money every year.

Another great concern of mine, Mr. Chairman, is the fact that the average age of the American farmer is 55 years of age. In talking with farmers throughout my congressional district—and I met with individuals; I met with farm groups over a period of days—very few of them were young farmers. Those that were young farmers were usually accompanied by their father or some member of the family of the farm of which they were either taking over or attempting to take over. This is something that we must address, because the whole future of agricultural America lies in the young farmers. If they are not there, what is the future going to be for agriculture in our country?

Mr. Chairman, as the chairman of the Congressional Rural Caucus, I wish to commend you for scheduling these hearings. These are terribly important for farmers, the farm families throughout the Nation. It is not just of local interest to those of us that represent agricultural America, but it is of national interest.

This was very poignantly pointed out to us. As the chairman of the Congressional Rural Caucus, I invited the Budget Committee to go to rural America to have hearings—to Missouri, to Oklahoma, to Arkansas, and to South Carolina— the Farm Belt. The chairman of the Congressional Budget Committee, I will never forget what he said at Enid, OK, at the end of a hearing. He said that the people he represented in Philadelphia, PA, had one great thing in common with those of Enid, OK. That was the fact that they thought it was important to eat. The whole Nation, Mr. Chairman, thinks it is important to eat. The finest bargain in this world is the food that our American farmers produce. We must do something to keep that bargain and to keep those people producing it.

At this point I request that two reports prepared by the Congressional Rural Caucus, one dated September 4, another dated today, September 11, be inserted in the record.

Mr. JONES of Tennessee. Without objection, Ike, they will become a part of the exhibit, if not the record.

[The material is held in the committee files.]

Mr. SKELTON. I also, Mr. Chairman, for brevity's sake, ask that my entire statement be inserted in the record and that I be allowed to abbreviate from it.

Mr. JONES of Tennessee. Without objection, it will be made a part of the record.

Mr. SKELTON. These reports deal with the Farm Credit Administration and the Farm Credit System. I feel like the messenger bringing the bad news to the king. This is not a pleasant report that I give you today.

Mr. Chairman, regarding a number of items, let me tell you this: as of December 31, 1984, combined total for loans in the Farm Credit System was $97 billion, including 12 Federal land banks for $52 billion, 12 Federal intermediate credit banks for $17 billion—that's with a "b"—13 Banks for cooperatives for $9 billion, 370 production credit associations for $18 billion.

Further, the combined total for nonperforming loans was $9 billion, including Federal land banks for $4 billion, Federal intermediate credit banks for $2 billion, Banks for cooperatives for $538 million, and production credit associations, $2 billion.

The combined total for allowance for losses on loans was $1.19 billion.

Even among the commercial banks, the statistics were such that in 1984 reports reveal that 75 commercial banks were placed in liquidation and that 25 of these commercial banks were classified as agricultural banks because they had at least 25 percent of their portfolio in agriculture; 18 of the 37 commercial banks liquidated during the second half of 1984 were agricultural banks.

Relating to the Farmers Home Administration, there is a substantial farm loan portfolio which has its share of the problems. As you know, many consider it the lender of last resort for farmers.

As of June 30, 1985, FmHA reported that there were 1.48 million borrowers with unpaid principal outstanding of $58.5 billion, including programs such as farm, community, water, waste disposal, business, industry, and rural housing.

There were 377,534 delinquent borrowers, Mr. Chairman. This is 25 percent of all of the borrowers.

There were 126,453 farm ownership borrowers with unpaid principal outstanding of $7.4 billion. That is on farm ownership borrowers.

There are 31,000-plus delinquent borrowers, which is 29 percent of all the borrowers.

Of the 131,992 farm operating borrowers with unpaid principal outstanding of $6 billion, there were 45,947 delinquent borrowers, or 36 percent of all of those farm operating borrowers were delinquent.

Emergency loan borrowers, 122,461; unpaid principal outstanding of $9.9 billion. Forty-four percent of them were delinquent, over 54,000 delinquent borrowers.

In the economic emergency borrowing area, which has principal outstanding of $4.2 billion with over 57,000 borrowers, 48 percent of them—in other words, over 27,000 of them—were delinquent.

These, Mr. Chairman, are a few statistics that I bring you not as a good message, but to press the fact that something must be done with the credit system for agriculture in America. If something is not done, we will see a continuation of the withering away of rural America and small town America. If that should happen, urban and suburban America cannot be far behind.

Thank you.

[The prepared statement of Mr. Skelton appears at the conclusion of the hearing.]

Mr. **Jones** of Tennessee. Thank you very much, Ike, for a good statement. We appreciate the work that you are doing for agriculture not only as a Member of Congress, but as chairman of the Congressional Rural Caucus, assisted by your able director, Frank Tsutras, who is with you today.

Frank, we appreciate the fact that you are here.

Mr. **Skelton**. I would like to commend him for the work he has done.

Mr. **Jones** of Tennessee. He has done a very superior job. I am very proud of the fact that I am a member of the Congressional Rural Caucus myself.

Our next witness is also from the State of Iowa, a Member of Congress, and a very able Member, very dedicated to agriculture, the Honorable Jim Leach from the State of Iowa.

Jim, we appreciate the fact that you could take the time. I am sorry that you had to wait this long, but that is just the way the ball rolls. Everybody wants to be heard today.

STATEMENT OF HON. JIM LEACH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF IOWA

Mr. **Leach**. Thank you, Mr. Chairman.

I sometimes wonder why we, in the minority, want to achieve majority status. You have exercised a great deal of restraint and dedication today in chairing this hearing. We are all appreciative for that.

Many of us are speaking on an issue that I suspect you know far more about than we do. Thank you for taking your time.

I have a very lengthy statement that I would like submitted for the record and would just briefly summarize it.

Mr. **Jones** of Tennessee. Without objection, it will be made a part of the record.

Mr. **Leach**. Mr. Chairman, there are two issues before us. One is whether to save the system and the second is who will have to pick up the tab. For a lot of reasons that you understand very well, I think there is a social imperative that rural America be saved.

The issue of who picks up the tab, however, deserves a great deal of attention and I think a great deal of philosophical questioning. There are a number of approaches ranging from a capital infusion to Government warehousing of loans, to Treasury guarantees, to Federal Reserve action. All have some advantages and disadvantages. I would just like to comment a bit on several and suggest another kind of approach.

First, with regard to the Federal Reserve Board, it only has two options. One is to buy bonds. The second is to open the discount window. The bond-buying option is only available for liquidity, not solvency, purposes. It could well be that, given Governor Wilkinson's recent statement, the Federal Reserve Board by law is precluded from buying any more bonds at this moment in time.

The discount-window option is always available, but as this is normally short-term assistance, it also can be expected to take rather substantial collateral and therefore, by definition, weaken the bondholder position.

From the perspective of a rural Member of Congress, it strikes me that any and all of the alternatives are preferable to letting the system go, but I think we all have to recognize that backing any of these approaches by the President or by an urban-oriented Congress is somewhat conjectural.

It may be very bad luck for the Farm Credit System today that the farm plight has surfaced at a time when there is growing concern about the deficit and that flexibility on spending is as eroded as at any time I have known in my time here in Congress.

Therefore, as attractive as a number of the alternatives may be to rural America, and to the Farm Credit System, particularly, for example, the warehousing approaches, I am very doubtful that Congress or the Executive is likely to pick up $30 to $50 billion in bad paper whether this is picked up or off the budget. Warehousing is a lending institution Nirvana, but it is a taxpayer's nightmare. I think taxpayers will rightfully ask whether they should be liable for the lending excesses at commercial banks and insurance companies, as well as for the poor risk management of the Farm Credit System and mistakes of bondholders.

Accordingly, as profound as the question is of whether to save the system, the real issue is going to be how to go about doing it. I am doubtful that the taxpayer is going to be willing or able to pick up the burden. Therefore, the question in a free enterprise society is going to be whether or not the bondholder is going to have to take a rather substantial hit. My own judgment is that will have to be the case.

The question then becomes: How do you maintain confidence in the system in the future if the bondholder is held liable? I will be introducing legislation today which represents one approach to answering this question. My proposal would establish a new authority—I have called it a Farm Credit Authority—to replace the current Farm Credit Administration.

The first duty of the authority will be to assess how much the liabilities in the system actually exceed the assets. Based upon that determination, the authority will be empowered to guarantee Farm Credit System bonds at a discount in relative proportion to the asset-liability relationship.

One might ask why bondholders would be willing to take a discount because they would have, among other things, to get the Federal guarantee and write off the portion of the loans not discounted. I can only suggest that the alternative is foreclosures. Bondholders will find that asset values in rural America decline even further. They will find themselves subjected to prolonged and lengthy litigation, and my guess is they will get a substantially lower return than they would get if the bonds were discounted from their current rate and guaranteed by the Government.

Then, in addition, the new authority would be empowered to give a Federal guarantee for a period of time, perhaps 5 years, for future bonds that are sold.

In terms of the advantage to farmers, it would be rather great because no longer would farmers be picking up the tab for the degree to which the system is insolvent, and loans—or at least lending rates—presumably could decline.

I would stress as a matter of more than slight consequence that Congress is going to have to act not only this fall, but in the next month or two; the system goes into chaos the moment bonds cannot be sold on Wall Street at a relatively credible relationship to the marketability of Treasury bills.

The important observation is not that the margin between Treasury's and Farm Credit System's bonds has extended to 1 percent in recent weeks, but that it hasn't gone to a far greater spread and that it didn't occur quite a bit earlier. I think timeliness is going to be a key issue.

I also think from the farm perspective it has to be understood that under current law the farmer stock is very much at risk. The approach that I will be introducing in legislation will be one designed to preserve and protect the asset value of that stock as well as to establish a cooperative stock insurance corporation analogous to the FDIC and the FSLIC. Because farmers' stock in reality is less analogous to stock than it is to a deposit, I think it ought to be protected up to $100,000 as a deposit in a bank or savings and loan is today.

In conclusion, let me just stress that I think the Farm Credit System should be saved, reformed, and reconstituted, but I am doubtful it should be at public expense; or realistically can be, and that if the budget is ever to be balanced, the buck has simply got to stop being passed around.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Leach appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Jim, for a good statement. We will read your statement in detail as you are filing it. We do appreciate your dedication and your interest.

Mr. LEACH. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Our next witness, who has waited a long time, too—and, Doug, I do apologize; you have been here once before. I think maybe you left for a short time and came back, but we do appreciate the fact that you are here and for the dedication that you have in this profession of agriculture.

The Honorable Doug Bereuter from the State of Nebraska.

STATEMENT OF HON. DOUG BEREUTER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEBRASKA

Mr. BEREUTER. Thank you, Mr. Chairman.

No apologies are needed. It was my intention to listen to your witnesses in any case because of my interest and concern.

I would say that the problem that you are attempting to address here today is most demonstrably felt in the States of Iowa and Nebraska. Since I represent an area of the State that has at least as high a problem with its commercial banks, as well as the Farm Credit System, I want to help you find the solution and will work with you to do that.

I had prepared in draft form some testimony today. I decided to take a rather unconventional approach in my testimony today and talk about something I am sure you are not going to hear about from anybody else testifying. I do that because I was fully confident that your excellent member, Cooper Evans, would give you a complete recitation of the approaches that have currently come to the attention of mankind on this problem, and he has done that. I have been privileged to work with him and consult with him.

I believe that the kind of solutions that we require in the United States for our farm problems, and specifically for the farm credit problems, are going to be very difficult politically to implement. Therefore, my attempt today is to try to arm you with some ammunition for the upcoming wars here in the subcommittee, on the floor, in the conference committee, in discussions with the administration, because I think the kind of solutions necessary are going to be quite unconventional, risky, and expensive—far more expensive than most people would estimate.

I want to talk today about the impact of monetary policy on agriculture. I have never considered myself to be a monetarist. I am suspicious of them. I am skeptical of them. I stay as far away from them as I can, even though I like them personally.

I have reluctantly and tentatively come to some conclusions about the genesis of our agricultural problems. I bring that up before this subcommittee for two reasons: First of all, recognizing that you have no legislative responsibility for monetary policy, but also recognizing that you do need to explain to your colleagues, to our colleagues, and to the American people why some dramatically different proposals must be made and, second, to give these ideas some exposure—and they are not all mine, by any means, because we have to avoid the kind of repetition of problems that have led us to this point.

Let me go back to the end of the Carter administration, the beginning of the Reagan administration, for my most dramatic examples.

At the end of the Carter administration we had a prime rate of 21.5 percent and inflation at 11.5 percent. From February through April, we had a very loose monetary policy which had a bad psychological impact, because it appeared that the Reagan administration may be influencing the Federal Reserve Board and that they were attempting to monetize the deficit.

Then suddenly we had 6 months of no growth in monetary supply, absolutely zero growth in monetary supply for 6 months, followed by a loose policy in December 1981 and January 1982, and then 6 more months where the brake was put almost totally on. So we had a stop-go kind of monetary policy, and this kind of erratic behavior continued—not as dramatically as those first two examples, but they continued.

The administration's stated goal, expressed by Secretary Regan, was to reduce the growth in money supply 50 percent over a 6-year period of time. Well, 75 percent of that reduction came the first year, and Secretary Regan was ridiculed for suggesting that we could bring down the inflation rate from 11.5 percent to 8.2 percent. He was ridiculed for that. In fact, it went down that first year to 3.8 percent. That is unprecedented.

In my lifetime the value of agricultural land in my State has never gone down, not until this period of time. Not once has it gone down. I think that the primary—this is the essence of what I want to say—I think that we did in this country, primarily through monetary policy, win the war against inflation much more quickly than we thought was possible, and certainly I will say now much more quickly than was desirable. But the primary casualties and fatalities, and fatalities that are still going on, was the American farm family, the people that owned agricultural land, the people that sold products to these farmers, and whole States like Nebraska and Iowa. I have been trying to convince this administration that the whole deficit reduction policy and the economic recovery will go down the tubes unless this problem is addressed.

I do not believe that Governor Wilkinson, as said here, came forth in a timely fashion to recognize the problems the Farm Credit System had. I told them on January 24 in an Omaha briefing that they were seeing the world through rose-colored glasses and there was nothing to justify their kind of optimistic projections. Indeed, they had only to look at Spokane to understand what was going to happen in the Omaha district.

I noticed in the paper last week an article by Lauren Soth, a syndicated columnist. He cited a paper delivered by three Iowa State University economists in August, last month, at the annual meeting of the American Association of Agricultural Economists. They said, and proved it, that the greenbackers and the various populists were right—that one of the groups benefiting most from inflation, even though their costs, their input costs went up, were farmers; that in terms of farm income, expanding farm markets, and prices, farmers fare best under inflationary policies when they are held in reasonable check.

They recognized it then, and it was this dramatic—the only way to explain the dramatic deflation in land values is to look at the combination of factors that came together. Yes, there was fiscal irresponsibility by the executive and legislative branch. Yes, we faced, and do face, unprecedented supplies of grain in surplus storage around the world, but those do not explain what has happened in the farm sector. They can only be explained in combination with the more dramatic factor, erratic monetary policy that has caused dramatic deflation in land values.

I think it is only when we fully examine this thesis and make sure that we are right that we can, first of all, avoid doing it again, and coming up with farm policies that have some opportunity to provide a reasonable income for good farmers. But, second, only by this can we justify to our colleagues and to the Executive branch and to the American public the kind of dramatic changes that we are going to have to make in farm policy and in changes in agricultural credit.

I wanted to expose you to some of my thoughts on this policy. As I say, it is a dramatic change in my point of view. I am not wanting to contribute to the conspiracy theories that go round any time we go into a recession or have economic difficulties.

In fact, I do not think it is explained as a conspiracy at all. It is simply a conflict between theories and a lack of recognition of what these factors together with a sporadic, up-and-down, stop-and-go, mostly stop monetary policy would bring.

Thank you, Mr. Chairman, for an opportunity to speak with you on these subjects.

Mr. JONES of Tennessee. Thank you very much, Doug, for that very enlightening statement.

I must admit, as you already have, that it is a different approach from what we have been thinking about or what we have been hearing here in the hearings.

We may have to be back in touch with you for some additional consultation.

Mr. BEREUTER. I will be pleased to do that. Sitting on the Banking Committee, maybe I can help you implement some things that we agree upon.

Mr. JONES of Tennessee. Thank you very much. We appreciate that.

Our next witness is a former member of the committee. He left us for other grounds. He is doing a fine job where he is, but he continues to be intensely interested in agriculture, the Honorable Byron Dorgan, a Member of Congress from the State of North Dakota.

Byron, we are glad to have you and appreciate your being here and the interest that you continue to have in agriculture. You may proceed.

STATEMENT OF HON. BYRON L. DORGAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NORTH DAKOTA

Mr. DORGAN. Mr. Chairman, thank you very much.

Let me assure you that I and Congressman Daub from Nebraska and some others who come from rural America are vitally interested in rural America and are working on issues that affect rural America over in the Ways and Means Committee.

We have kind of a twin set of goals here, it seems to me, in Congress with respect to farmers. One is to try to straighten out the farm program, and the second is to try to straighten out the tax program as it affects farmers, because it has a radical impact on agriculture.

Let me say that you have a generous amount of testimony from many witnesses. I would like to give you a statement to put in the record. I will summarize it very briefly.

Mr. JONES of Tennessee. Without objection, it will be made a part of the record.

Mr. DORGAN. Generally speaking, the subject of this hearing, as I understand it, is farm credit. Specifically, a number of people have addressed the most recent disclosure by the Governor of the Farm Credit Administration that there is a substantial problem in the area of the loan portfolio held by the Farm Credit Administration. I would like to speak very generally first.

This is not a question of whether we respond to the problems in the area of agricultural credit or credit for family farmers. We don't have the luxury of deciding whether; we must respond.

The question that confronts us as Members of Congress is, What is the appropriate response? What shall we do? We have a Farm Credit Administration that says it is in serious trouble. We have somewhere over 400 agricultural banks; that is, commercial banks that are deemed agricultural by the description of the amount of their portfolio that is in agricultural loans, that are so-called problem banks. My guess is the very same conditions that present the Farm Credit Administration with their problems are the conditions that lead us to have nearly 400 banks that are so-called agricultural banks listed on the problem list.

What do we do about that? Well, Hubert Humphrey used to talk about trickle-down versus percolate-up. It seems to me that if you don't do something to stop the bleeding at the bottom, we will spend the next 10 years trying to fix the loan portfolios at the top or trying to fix the ability of those involved in making credit available to family farmers at the top, but we will not solve the problem. We must, it seems to me, do two things:

One, try to stop the bleeding at the bottom. That has to do with the work you were involved in yesterday afternoon in the provisions of the farm bill, the development of an amount of money that we are prepared to spend on agriculture and the consideration of how we use that money to provide the best support possible for the family farmers.

If we do that properly, if we develop through a farm price support system the mechanism by which family farmers can get a decent price for their product, ultimately that strength will flow through to that farmer's ability to repay loans that are out there from the lending agencies.

Let me just say parenthetically there, that this country in its decision of whether or not it wants to do that the right way must make a policy decision about whether or not it is in America's interest to maintain a network of family farms. Japan has made that decision. Countries in western Europe have made that decision. We have not made that decision. If we do and when we do make the decision that it is in this country's interest to have a network of family farms, we will develop a farm program that has a substantially different approach to providing price supports than the present program.

Now if we can stop the bleeding at the bottom, or at least repair some of the problems that occur because of the lack of a price for the product, and we can repair that either through an improved market price—and we all hope that happens, but are not necessarily expecting it to happen in the short term—or we can repair it through a wiser use of the resources we develop in farm price supports and a more targeted approach to using those farm price supports, if we do that, we still are going to have to deal with the problems that specific credit institutions face.

Let me say that last evening I read a number of things that were written by Congressman Leach, who I understood testified recently. I have been attentive to some of the things that Congressman Evans has talked about. I think there are some very constructive thinking going on and some very constructive specific proposals that are being offered on how to deal with some of these problems.

I am particularly impressed by some of the proposals in Congressman Leach's writings and offerings, because I think what he is suggesting is a method of reorganizing in a way that will provide a remedy without requiring massive amounts of Federal money.

Let me, Mr. Chairman, take 1 other minute and say that this week we had 150 North Dakotans come to Washington, most of them farmers. They came because they felt very frustrated and they didn't know what to do. They wanted to demonstrate to somebody that this thing is serious.

One of them, a friend of mine named Allen Richard, who is also a State legislator, left a message that he had written to the President and to the Congress at my office, and he said, "Read it when you get a chance."

Last night I read it and he said it in very simple terms, and I want to share just two paragraphs with you because I think it is important to describe what this problem means to rural America.

He talks about the economic devastation that is going on that all flows from the lack of a price. He said in his township in 1980 there were 12 farmers. Now there are seven, and only one retired. He said on Main Street of his hometown—there are 1,000 people in his hometown—they have had four businesses close in the last 5 years, and apparently another three are on the brink.

He said that his legislative district has 25 townships and 5 communities. Five years ago they had four new car dealers in that district. Now there are three. Five years ago there were four tractor dealers. Now there are only two. Five years ago there were 20 percent more farmers in those 25 townships than there are today. One year from today there will be 10 percent less than there are now, if estimates hold true.

His point was, and I think it is very important, that the economic devastation is occurring right now largely because we have not decided what the Japanese, the Italians, the French, the Germans, and the others have decided—that we, by God, need to do what is necessary in farm policy to allow a network of family farms to survive.

Part of that is to solve the farm credit crisis with the kinds of suggestions that, as I said, Congressman Evans, Congressman Leach, and others have very constructively proposed, and another part of it is the work that you were doing yesterday that is so important in providing a price support program that gives family farmers an opportunity to understand that they will have an income if they produce the product in the long term.

Mr. Chairman, you have been, in your work as chairman of the Conservation, Credit, and Rural Development Subcommittee, very diligent in working on these issues for the 5 years that I have been in Congress. I just want to compliment you for your attentiveness and your search for the kinds of answers that will keep the hopes and dreams of family farmers alive in this country.

[The prepared statement of Mr. Dorgan appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Byron. We appreciate your cooperation and your statement. I will assure you that the full subcommittee will take a look at it and probably follow some of the directives that you have suggested here.

I appreciate the fact that all the Members have taken the time that they have to be here.

Is the Hon. Bob McEwen here? He is next on the list.

I didn't think he was.

Without objection, his statement will be filed for the record.

[The prepared statement of Mr. McEwen appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. The next witness is a dedicated agriculturalist, a Member of Congress from the State of Nebraska, our good friend, Hon. Hal Daub, who has been before this subcommittee before.

Hal, take your time but be as brief as you would like.

STATEMENT OF HON. HAL DAUB, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEBRASKA

Mr. DAUB. Yes, I certainly appreciate the tactful suggestion. I am going to be brief, but I am going to kind of wind my way through the statement I prepared. Quite honestly, Mr. Chairman, it ends up being much shorter than if I would decide to summarize, as may have been the case in prior testimony this morning. So let me not wander. My preamble is best if I stick to my script.

Mr. Chairman and members of the subcommittee, I am pleased to be here. You have a tough assignment, and I am glad that you have decided to convene this public hearing to commence to examine the problems that are affecting our Farm Credit System.

Prior to coming to the House, I worked for over a decade in agriculture and with Farm Credit System lenders. Although not a member of the Agriculture Committee, I have continued to be interested in the Farm Credit System.

For some time now, I have been speaking with other interested colleagues in the House, meeting with administration officials and representatives of the Farm Credit System, including Governor Wilkinson, about the financial imbalances not only in the Omaha district but systemwide.

In one sense, the troubles affecting the system reflect the fundamental problems besetting agriculture generally. A confluence of lost export market because of trade embargoes and a high dollar, adverse weather, high interest rates driven by high Government spending, shortsighted and inflexible farm policy, changing diet trends, plunging land values, and just plain bad luck have resulted in extraordinary industry stress. Not surprisingly, this stress has manifested itself in the largest holder of agriculture debt, the Farm Credit System.

Farmers, ranchers, and their service industries have serious cash-flow problems because of low prices and large debt service requirements. Gross farm income is expected to drop more than 30 percent this year, clouding the prospects about farmers' ability to service their $212 billion debt.

I should add that, according to USDA, more than 80 percent of all farms have debt-to-asset ratios of less than 40 percent, reasonably tolerable levels. It is the rest of the borrowers, roughly 20 percent, in which we find a concentration in the Midwest that faces serious financial difficulties. In Nebraska, farmland values have declined 50 percent since 1981.

The Farm Credit System is the largest farm lender. Much of its loans are secured by this deteriorating farmland collateral.

Figures were just released for the second quarter ending June 30. Losses for the first 6 months of 1985 were some $206 million. This compares to a $41 million loss figure for the first six months of 1984. Anticipated losses on the year is now projected between $600 and $900 million. The comparable figure for 1984 was a grand total of $447 million.

The system has begun to respond to its problems. Consolidation in the Omaha district bank is underway. The Farm Credit Administration just approved a regulation allowing it to initiate funding transfers among lenders to assist faltering system banks and associations.

The system has approved a $340 million assistance package for the Omaha four-State district. I was pleased by this development. However, in light of Governor Wilkinson's recent comments, which I might criticize to a degree as somewhat of an overreaction, but nevertheless getting closer to the truth, and the numbers that we are now receiving, this amount will probably not prove sufficient.

I understand that the Federal Farm Credit Board of the FCA has scheduled a board meeting in October to discuss options for an assistance plan. It appears the system can cover its losses for the next 9 to 12 months, but the outlook beyond that is uncertain.

Part of the problem is that we don't yet know the true extent of it. Outside audits are underway, but anything this subcommittee can compile to shed light on the magnitude of the challenge we face would be invaluable.

I am encouraged by the attention this subcommittee is giving this situation and an examination of the options being discussed in advance of the presentation of the FCA recommendations which I hope we can expect from their October meeting. That will be welcomed.

Some questions I urge you to address will be as follows:

What is the extent and availability of current loan reserves? I have seen figures anywhere from $1 to $7 billion in the system to cover loan losses. We need to know how much is available and, more importantly, how much is liquid enough to apply to current and projected losses.

Currently, FCS has reserve requirements exceeding commercial lenders by two to three times. There is good reason for this The nondiverse portfolio of FCS means there is greater risks inherent in the system. The subcommittee might consider the possibility of lowering these requirements possibly accompanied by permitting limited portfolio diversification.

In any event, recognize that the reserve requirement, if lowered to the same level as the commercial bank outside this system, might present another set of inherent risks.

Any congressional assistance should include significant Federal oversight reform. Greater oversight of the money management practices of the system is a must. The current situation has highlighted how vital the system is to the agriculture community. More stringent reviews will be needed to monitor both the progress of the system through its current problems and to give ample warning of future storm clouds.

There has been considerable talk about creation of a new organization to warehouse marginal loans or assets of troubled financial institutions. I am concerned that we might create, "a land and equipment asset reserve" which holds down market prices. We have seen this problem with Government-stored commodities. Permitting land and equipment values to rise again must be a major objective.

I would be very seriously concerned that any talk about a warehousing system might be sort of like the current dislocation with foreclosures and bankruptcies—that we throw all this land into that turbulent water in the stream bed. When it gets to the first set of abutments at the first bridge, all that debris gathers; it doesn't pass under the bridge, and it builds up a massive pressure and then the bridge gives out.

I would be very concerned about warehousing from the point of view that if you don't allow that land to move in an orderly way into the warehouse and then out on a schedule, that if it just all builds up inside that warehouse, the warehouse will collapse. I think it is very important, if that concept is considered, that when it comes in, a scheduled date of disposition occur, and then when the next set of land comes in, it rotates some more. Very likely, politicians will be tempted to leave it in there just as long as we think a little of the heat is off of us with respect to land values or with respect to liquidation of debt.

If this option is seriously considered, perhaps this problem could be addressed by ensuring orderly sellback provisions. And I would add an orderly liquidation on a rotating basis. The original farmer, indeed, I think we all could agree should be given the first right of refusal to buy back the property at the end of some specified period of time.

I have been told that a direct infusion of Federal assistance may be less costly than a new corporate holding company. That matter is now being evaluated, and I trust we will all get some benefit from that analysis shortly. It would obviously avoid the farmland storage problems that I have just alluded to.

In conclusion, we must remember that Congress is really the culprit behind the Farm Credit System's woes. High Government spending has dealt the farmer and the system double blows. It is shrinking an export market with a sky high dollar and has foisted enormous interest payments on the producer.

Ultimate stability in the Farm Credit System and the agriculture community in general will only arrive when we stand on the floor of the House and make the hard spending choices needed to reduce interest rates. The kind of pain and dislocation that is occurring now in our rural credit markets can realistically be laid at only one doorstep, my fellow colleagues, and that is ours.

Thank you very much, Mr. Chairman.

[The prepared statement of Mr. Daub appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Hal, for a real good statement. I will assure you I will read the whole thing. I did not hear all of it. I had to leave for just a moment, but I will read it and, as usual, give lots of consideration to what you said.

Mr. DAUB. Thank you very much, Mr. Chairman.

Mr. JONES of Tennessee. Is the Honorable Jim Slattery in the room?

[No response.]

Mr. JONES of Tennessee. There is one other remaining member as far as I know to be heard, the Honorable Jim Lightfoot from the State of Iowa.

Jim, we are delighted that you are here. With the background that you have, I am sure that you have a good statement for us today.

STATEMENT OF HON. JIM LIGHTFOOT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF IOWA

Mr. LIGHTFOOT. Thank you, Mr. Chairman.

I guess the privilege of batting here in the cleanup position is that we get a chance to hit a grand slam and bring everybody in; is that correct? We hope. We will see what happens.

I appreciate your letting me testify today. As you know, I contacted your subcommittee earlier this year to request an investigation into the farm credit situation. So I am very grateful that you have chosen to look into this very critical problem.

I first became involved with the Farm Credit System as a farmer's son growing up in southwestern Iowa; later on, as an agricultural reporter with a major media outlet; and as a Congressman just the last few months, when it was obvious that farmers in the district were having difficulty securing funds with their spring planting.

In the midst of several farm bank closings—in fact, in Iowa, I, unfortunately, hold the record for the number of banks closed in the district. We have six now that are locked up. Fortunately, they haven't locked up. They have changed ownership.

I put together some town meetings with panel discussions in which Farm Credit System officials agreed to take part, along with commercial lenders and officials from the Farmers Home Administration.

Mr. Chairman, at these meetings frustrations surfaced when questions from the audience were answered by the Farm Credit System officials with very vague replies, confusion, and absolutely no straight answers.

By that time, around the first week of July, problems within the system appeared to be growing. I was scheduled to go on a trade mission over to Japan. I canceled that trip to go back to Iowa to look into the situation further. I held a series of town hall meetings across the district. They were very, very heavily attended.

The message that we got was very disturbing, to say the least. Foremost in the messages from the farmers was the term "no forbearance." Farm member control was being usurped by a hired staff. No information was being released to the members, or sketchy information.

To give an example, the south central PCA located in Creston, IA, had put their members' stock into liquidation back in January, but no one knew this until May 13 when the PCA announced that stock had been frozen.

Our office receives many, many examples of lack of forbearance. People have been foreclosed because only one payment was late. I encountered a situation this morning on the phone with a gentleman who had been with the system for a number of years, had never missed a payment. He was something like $1,000 short in making his payment. He told them he would have it within 2 weeks, the balance. He did. He handed the man the balance of the payment, and he handed him his foreclosure papers. I don't believe that comes under the heading of "forbearance."

In other cases we have seen alternative financing that is not even been considered. It seems that foreclosure is the cry and forbearance is not a part of the Farm Credit System's vocabulary.

I think management of the system is refusing to accept responsibility for the condition of the system. Instead, they are pointing their fingers at the general farm situation and at Congress for not coming out with a farm bill. I think this attitude has been widely reflected in the press reports we have seen in the past few days.

Yet, with the lack of information on the internal status of the system, I think it is a little difficult for us in Congress to prescribe a remedy. That is why I joined some of my colleagues in requesting a GAO investigation and audit of the system, and I think that is why your hearings are so important. If we are going to solve the problem, we have to know what it is.

As you may be aware, the Government Operations Subcommittee on Government Information, Justice, and Agriculture, of which I am a member, held some hearings in July inviting officials from the banking industry and the Farm Credit System to testify on the subject of agricultural credit problems.

As well, last week I appeared before Senator Grassley's Judiciary Committee to discuss the situation, along with my colleague, Cooper, and Jim Leach, who was here earlier, and Congressman Tauke, and Neil Smith were there as well. It was an interesting hearing.

The Senator mentioned some of the things that came out of it. My perspective of the hearing—there were about three major points.

One, it seems clear to me that the Farm Credit System management is in many cases not totally aware of what is happening inside the system. They are unaware of some of the foreclosure procedures. There seemed to be a disagreement on what they were doing.

Mr. Harling, for example, didn't know about some letters that were sent out to members that related to foreclosure procedures, which seems a little strange since he heads up the system in Omaha.

They also seemed to be somewhat uninformed about liquidation of PCA property. I mentioned that. Later the fellow from the PCA who had been liquidated came up and said, in fact, it had been liquidated. They were not aware of that at the Omaha level.

About the south central PCA situation I described earlier, they were not aware of that, supposedly.

Two, I think the Farm Credit Administration has absolutely no power. It is, in essence, a toothless tiger. They can identify a problem, but they can do literally nothing to solve that problem.

For example, a number of irregularities have turned up: a house that was financed in the city through the Omaha Federal Land Bank, members' names were released to a wide number of business people, including some on that list who no longer owed money to the system. I understand this morning that there will be some lawsuits coming out of that.

Three, poor internal accounting has allowed huge losses to be overlooked. To mention one oversight, as you are well aware, they have never audited themselves. They hired Price Waterhouse & Co.

In Omaha they reported a $2.7 million profit the first 6 months. The Price Waterhouse people discovered $50 million in losses they had overlooked. Instead of that $2.7 million profit, they should have a loss of $47.3 million. I think that is quite an oversight.

I think it is obvious from what we know that the system needs some responsible regulation. I think the Farm Credit Administration must be given some power in that area. This will have to be a first step. I think we need to get a rulebook that everybody will be playing by.

The management of the system I think must be evaluated at all levels and necessary changes must be made. Careful and accurate evaluation of the financial condition of the system must be made to determine where funds can be shifted and how. The GAO audit will be of some assistance in this regard. However, thorough completion of that audit is going to take a great deal of time—that is something I don't think we have.

Recent media reports have brought to light the fact that land values have fallen perhaps further in our State than anywhere in the country. I think this helps to explain the dire condition of the Omaha district, which compared to other farm country districts, not to mention the frustration which has occurred in our efforts to address the problems they are facing, we find them in worse shape than the others.

The farm credit system represents about 40 percent of the agricultural borrowing, and actions by the system have perhaps greater impact on farmers in our district than any other factor.

I find it somewhat outrageous that officials within the system for months told myself and other Members of this Congress, when we expressed concern, the system could take care of its problems internally with no immediate help from the Federal Government. Of course, that now has turned around.

All of it leads me to one conclusion: I think, while the Farm Credit System may ultimately need some type of bailout, such a financial aid package should be as a last resort. I think we have to get them a rulebook to play by, and we have to look within the system and identify the problems and go from there.

Our role cannot be to save the system at any expense, which I feel is what the Farm Credit System management seems to want to do. Our role must be to help provide farmers with adequate credit at reasonable cost in order to preserve American agriculture.

We must—and I underscore "must"—protect the farmer members of the Farm Credit System and the communities that depend on them.

Mr. Chairman, thank you for the opportunity to be here this morning. We certainly will work with you in any way we can and wish you God speed in your efforts here.

[The prepared statement of Mr. Lightfoot appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Jim, for a good statement. We appreciate your cooperation and your offer to do more.

Is there any other Member of Congress present who wants to be heard?

[No response.]

Mr. JONES of Tennessee. Mr. de la Garza.

The CHAIRMAN. I wonder if it might be well if we give unanimous consent for statements to be submitted by any other member that might not have made the hearing.

Mr. JONES of Tennessee. Without objection, I think that should be permitted.

The CHAIRMAN. I thank the gentleman.

Mr. JONES of Tennessee. We have already done that for the ones that are not here who have made a request that they be included. There were two or three who did not show.

That completes the morning session. Now it is 1:30. We are ready to go on the afternoon session.

I believe we are ready to start with the witnesses on this panel who are here, and if the others have not appeared by the time these witnesses complete their testimony, we will move to panel No. 2.

Our first witness on the list today was Jim Nichols, the commissioner of agriculture from St. Paul. He has not appeared yet. Then JoAnn Smith, National Cattlemen's Association; she has not appeared. And then we move to Rollie Lake, Communicating for Agriculture, Fergus Falls, MN.

Mr. Lake, we are delighted that you are here, and you may proceed.

STATEMENT OF N. ROLLIE LAKE, PRESIDENT, COMMUNICATING FOR AGRICULTURE

Mr. LAKE. Mr. Chairman, members of this subcommittee, my name is Rollie Lake and I am president of Communicating for Agriculture. We are a nonpartisan rural membership organization with members in over 40 States.

CA is an organization working for and speaking for agricultural America. We are based in Fergus Falls, MN. I'd like to stress that CA is in addition to and not in place of any other farm or rural organization. CA strives to unite and not divide agricultural America.

We at CA appreciate the opportunity to once again appear before this subcommittee and to take part in today's hearing on agricultural credit conditions.

Mr. Chairman, since the last time that we appeared before this subcommittee on the issue of agricultural credit, conditions for American farmers and ranchers have seriously deteriorated. The crisis has deepened in agricultural America. It is a crisis of troubled farm debt for the American farmer and of classified assets for agricultural lenders. It is a crisis which must and can be met.

There are a large number of farmers and ranchers with troubled debt who are in various stages of financial difficulty. For many of these farmers, economic survival is a serious question; and to help this group, there must be a restructuring of farm and ranch debt.

Mr. Chairman, we have heard here today that unless something can be done quickly, a number of farmers will not be able to get funds to last until next year.

Mr. Chairman, today we would like to discuss with you a plan to restructure farm debt, known as the Modified Debt Recovery Act of 1985, H.R. 2064 and S. 719. The Modified Debt Recovery Act is a plan to buy time. It is a plan to make cash-flow work, and it is a plan to share risk. It is a plan which can be implemented today. The Modified Debt Recovery Act uses existing resources. No need for any new level of administration. It uses the expertise of private lenders and the lending programs of the Farmers Home Administration. Both of these resources are already in place. What is needed is for these resources to be brought together in a modified form. That is what the Modified Debt Recovery Act accomplishes.

Mr. Chairman, rather than take the time of the subcommittee today to discuss the figures which we are all familiar with, all of which point to the agricultural credit crisis, I would like to get right into the heart of the Modified Debt Recovery Act and go through some examples to show how it can effectively restructure troubled farm debt.

Today the situation is critical for our family farmers and ranchers. All across agricultural American, the farm debt problem has become a crisis situation.

We all realize that price, commodity price, is the No. 1 problem. But the need to restructure troubled farm debt remains a high priority and principal need if we are to keep family farmers and ranchers in business.

Mr. Chairman and members of the subcommittee, I would like to refer you to the modified credit illustrations following to demonstrate what the program can do to restructure an individual's troubled farm debt. These illustrations are from page 9 of the Modified Agricultural Debt Recovery Program, which is attached in its entirety to this testimony.

The program is meant to be used for family farm and ranch operations with a reasonable chance for success. It is meant for those who can still bet the family future that their future is with farming. The program is designed for farm and ranch families who are in financial difficulty, yet who can be helped with the right program. It is targeted to family farm and ranch operations with annual gross sales between $40,000 to $250,000.

It is the only program now on the table that can come close to solving the problem and handle the amount of debt restructuring that is necessary. In addition, Mr. Chairman, it is one solution to the tremendous problems the Farm Credit System is presently having.

Again, I emphasize that the resources already exist to accomplish this program. The local lenders are already in place. The Farmers Home Administration programs are already in place. What is needed is to modify these programs and bring these resources together.

Now, let me show you by example how the CA Modified Debt Recovery Program works. We have a farm borrower with $100,000 worth of indebtedness but a cash-flow of $21,000 available for that restructuring which would include interest and principal payments. Example No. 1, this would be the regular commercial loan program. For 5 years at 13.5 percent, he would need $33,500 for an annual payment. The payment deficit would be $12,500, and because of this deficit, this would classify this loan.

Example No. 2—here we have taken the Approved Lender Program along with the guarantees from the Farmers Home Administration in the accord, and there we can restructure this loan over 7 years with the interest rate the same, at 13.5. But again we find we need $27,785 in place of the $21,000 that is available. We have a deficit of $6,785; again, this would make this loan a classified loan.

There is one part of the Approved Lender Program, the Guaranteed Loan Program, whereby you can go for 15 years, like in a dairy operation, which self-perpetuates itself. And here we would find, by using the Approved Lender Program, this loan would work itself out without any further modifications.

Now, if we go to example No. 3, where we use a CA Modified Debt Recovery Program, here we bring the direct lending authorities of the Farmers Home Administration and we lay them on the desk of the private lender. And by doing this, by using the Insured Loan Program, which is 10.25 percent, it could be modified up to 15 years in the Limited Resource Loan Program at 7.25 percent and, again, modify that up for 15 years along with the Approved Lender Program. We cap our interest rate at 2.5 percentage points above the discount rate. This our bankers in Minnesota have agreed would be a fair rate on a blended program. By doing so, in example No. 3A, we find we put $50,000 in the Guaranteed Approved Lender Program and $50,000 in the Insured Loan Program. Between those blended amounts, using the blended programs, we find that we can make this loan cash-flow with a debt reduction of $20,601, which leaves us a balance of $392. If we go to 3B, by using the Approved Lender Program and the Guaranteed for $60,000, Limited Resource for $40,000 at 7.25 percent, we find we have a balance after making our annual reduction of $863.

So you can see from these examples that the CA Modified Debt Recovery Program will work.

Mr. Chairman and members of this subcommittee, I would like to thank you for taking the time to go through these examples. I would especially like to thank Representatives Arlan Stangeland, Vin Weber, Tim Penny, and Tom Daschle for being sponsors of the Modified Debt Recovery Act of 1985.

I emphasize that there are many farmers who can be saved with the right debt restructuring plan. This legislation has been formally endorsed by farm groups, banking organizations, Governors, and State legislators throughout the country. I believe, as they do, that this program is the right program. It is the only program now on the table that can come close to solving the problem and handle the amount of debt restructuring that is necessary and it is a program that can be accomplished today.

Mr. Chairman, thank you for this opportunity to once again appear before this subcommittee. This is the most important issue facing agricultural America today, and I would be happy to answer any questions you may have.

[The prepared statement of Mr. Lake appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Lake, for your statement and for the fact that you've gone through it rather hurriedly. And we'd like to take the opportunity here, and the privilege, of communicating with you for any questions that we might need to ask you at a later date. Some of the sponsors of your legislation are on our committee; we could use them also if we need to, and then because of time I think we'll forgo questions at this time.

Mr. Evans, do you have a question?

Mr. EVANS of Iowa. I don't want to interfere with your approach to the hearings. I do have one short question——

Mr. JONES of Tennessee. Well, I think we can entertain one or two. I just didn't think we could get into a lot today.

Mr. EVANS of Iowa. All right.

Mr. Lake, I am very interested in your proposal. Earlier today I suggested that some of the problems could be handled through Farmers Home Administration and the existing program with appropriate modification.

My question is very, very short. If the administration wished to do so, and I suspect they would not, but if they did could they not do that under existing law and authority?

Mr. LAKE. This program could be easily put through with just administrative orders, without any legislation. We tried that route last fall without any success.

Mr. EVANS of Iowa. Thank you, Mr. Chairman. I yield back.

Mr. JONES of Tennessee. Thank you very much, Mr. Evans. A good question.

Mr. Weaver, do you have any questions?

[No response.]

Mr. JONES of Tennessee. Lindsay.

Mr. THOMAS. No.

Mr. JONES of Tennessee. OK.

Well, Mr. Lake, it's not because of the interest we do not have in your program, it's just because of the time element. And we will take the privilege of communicating with you.

Mr. LAKE. Thank you.

Mr. JONES of Tennessee. Our next witness will be Mr. Vance Larson, who is at the table, with the National Turkey Federation. And I saw Lou Walsh earlier and spoke with him. Lou, we're delighted that you're also here. You may join the witness table, if you'd like.

Mr. WALSH. Thank you, Mr. Chairman. I would rather take his picture, if that's all right.

Mr. JONES of Tennessee. That's OK, too. How about taking ours while you're taking his?

Mr. WALSH. We may have to talk about that, Mr. Chairman.

Mr. JONES of Tennessee. We are glad to have you, Mr. Larson, and you may proceed.

STATEMENT OF VANCE LARSON, PRESIDENT, NATIONAL TURKEY FEDERATION

Mr. LARSON. Yes, Mr. Chairman, members of the subcommittee, my name is Vance Larson. I am president-elect of the National Turkey Federation and the president and general manager of Larson Products in Sargeant, MN, which is quite a small town in Minnesota.

The National Turkey Federation is the only national trade association representing the turkey industry in the United States. The members of the federation are responsible for the production and marketing of 95 percent of the Nation's turkey crop.

Larson Products is a family held farming operation which includes my father and brother. Our farming enterprise includes the production of 220,000 turkeys annually and a hog production facility producing 4,500 hogs a year. In addition, we have 1,700 acres in corn and operate an elevator in our area.

At this point, Mr. Chairman, I wish to compliment you for your forward thinking in scheduling these hearings on the farm credit situation which now exists in agriculture. The availability of credit and the cost of money is not only important to the turkey growers of this country, but is of extreme concern to me personally, as related to the farming operations in which Larson Products is involved.

The Farm Credit System plays a very important role in the overall viability of not only the agricultural sector, but also impacts as well on the national economy. It is imperative that agriculture be sustained by a strong credit position on the part of farm lending institutions.

It is my personal opinion that unless the Farm Credit System receives an infusion of capital within the next 60 days, the farmers who are solvent today will not be solvent tomorrow.

At this time, interest rates for farm credit in the Midwest are running 5 to 7 percent above the prime rate. Everybody borrowing money today is paying a lower rate of interest—except the farmer. For example, farmers borrowing from the Production Credit Administration in my State are paying anywhere from 13.56 to 15.89 percent, which includes stock.

And in the same vein, farmers borrowing from the Federal Land Bank are paying an interest rate of 13.2 percent. With farm commodity price levels being what they are today, coupled with price projections for the rest of the year and into 1986, there is absolutely no way a farmer having these kinds of heavy interest loads can remain solvent.

It is really a paradoxical situation in that our Farm Credit System, which is designed to assist farmers in the production of food and fiber for this country, could turn out to be the instrument which self-destructs these very same producers.

We have to conclude that the Farm Credit System cannot help itself internally at this time. For example, a freeze on PCA stock would be devastating, not only to the borrowing farmers, but would ultimately force agriculture into borrowing from other sources if such sources could be found. It is our understanding that commercial banks today have ample supplies of cash, but absolutely no interest whatsoever in developing agricultural portfolios. The bottom line is that agriculture in total is in such a financial disarray and filled with so much uncertainty that the majority of commercial banks have no interest in making agricultural loans.

Let me give you an example of what is happening today in Minnesota as far as agricultural-related banking is concerned. The First Bank System in our State just recently announced the offering for sale of 28 banks within their system. In the true sense of the word, this is a reflection of a negative attitude by the system on the ability of agriculture to repay loans. There is no question in our mind that once these banks are sold, they will no longer be interested in making loans to farmers. What this really means is that these credit sources for farmers will dry up. Such a development places even greater importance on maintaining a strong Farm Credit System as we have known it in the past. Otherwise, where do agricultural producers turn for credit?

It is our reasoning that the farm credit crunch being experienced now is not necessarily the fault of the Farm Credit System. It's a combination of circumstances beginning over a decade ago when farmers were encouraged by our Government to gear up crop production to full potentials—that there would be a world shortage of food by the 1980's—and the export market for grains would continue to expand. And our agricultural lending agencies were caught up in the same fervor. However, all these wonderful projections failed to materialize with the end result being lower and lower farm commodity prices and greater and greater debt loads on farmers. Consequently, let's not put all the blame on our farm lending institutions. It is my firm conviction there is not a credit institution in this country that could withstand a 50 percent reduction in assets over the past several years and remain solvent.

It appears to me the credit crisis in agriculture today is the end result of several factors not necessarily related to the lending practices of our Farm Credit System. We would suggest that the following situations and developments have placed farmers and our lending institutions in today's precarious position: One, the grain embargo of several years ago; two, our current budget deficit; three, the strong U.S. dollar; and four, the unfair and subsidized trade practices of foreign governments in Third World markets.

Nevertheless, it is imperative that the Federal Government utilize every resource available to shore up the Farm Credit System and in a manner that loans to farmers will be at competitive rates of interest. Otherwise, bankruptcies in agriculture will increase in geometric proportions. This, in turn, will trigger a negative domino effect involving many businesses, both large and small, who provide goods and services to farmers, not to mention the negative effect such a scenario will have on our national economy.

In conclusion, Mr. Chairman, the financial stability of our Nation's food producers is at a crossroad. Also at a crossroad is the interest of the American consumer as related to a continuing supply of food at a reasonable cost.

And really, as I look at the whole situation today, our big problem is prices. And somewhere along the line we're going to have to come to grips with that to get a decent return for agriculture in this country, and that is one that at this point really has not been addressed. And we'll have to somewhere along the line cut some production to get a decent price, and we're going to have to have the Nation's people behind us to solve this problem.

Thank you for the opportunity of appearing here today. We will be pleased to answer any questions that you and the members of this committee may have.

Thank you.

[The prepared statement of Mr. Larson appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Larson, for a very good statement and one that I'm sure that this subcommittee will even want to reread.

Does any member of the subcommittee have any questions to Mr. Larson?

[No response.]

Mr. JONES of Tennessee. If not, Mr. Larson, in the need for more time we will press on and take the opportunity to communicate with you anything that we might want to discuss with you at a later date.

Mr. LARSON. Thank you very much.

Mr. JONES of Tennessee. We appreciate you two gentlemen being here, who we've just heard, and I see that Hon. Jim Nichols, the commissioner of agriculture from St. Paul, is here, and Ms. Jo Ann Smith is also here, so this will complete panel No. 1.

So, commissioner, we are delighted that you are able to make it, and we will be happy to hear from you at this time.

STATEMENT OF JIM NICHOLS, COMMISSIONER OF AGRICULTURE, ST. PAUL, MN

Mr. NICHOLS. Thank you, Mr. Chairman. I will keep my testimony brief. It's been a long day and I don't suppose you have had a chance to eat lunch yet. I ran out and ate, so I'm luckier than you.

I'm a farmer from southwestern Minnesota. I'm also the commissioner of agriculture from the State of Minnesota. I am a user of the Farm Credit System; I borrow all my money from the Farm Credit System, operating through the PCA and the Federal land bank. I believe in the system; I believe in farmer-owned cooperatives. The system has been very good to me. They started me out farming 14 years ago, and I enjoy a good relationship with the Farm Credit System and I appreciate what they've done for me.

I am also here to testify against bailing out the Farm Credit System. Despite the fact that I am a user/member and that I hold a great deal of B stock which is at risk, I don't think bailing out the Farm Credit System is a solution to our problems. We have a cyclical economy, as you know very well, Mr. Chairman, and this is a symptom of that disease, the collapse of the Farm Credit System is nothing more than a symptom. Treating the symptom will do nothing for the disease, and as long as you treat the symptom you'll never get to the disease and you'll be bailing out the Farm Credit System on into infinity and the rural banks, which are not totally ignored in this proposal, but they are failing just as fast. On down the line, contract for deedholders, which are retired people living in town, they're losing their assets as their farms are returned to them.

So, I think if you start bailing out one part of the system you will go on forever, and I don't think you can afford it. You can pass a good farm bill, Mr. Chairman, that is cheap, that will cost you not a great deal of money. The proposal we think is best for farmers—the only one which would raise farm income—will cost you $8 billion. That's considerably cheaper than bailing out the Farm Credit System and whatever you do, you're going to have to pass the farm bill as well.

I think what's more important, I'm a member of the St. Paul district, which is the largest district in the Farm Credit System. I think it's a well-run district; Mr. Bergie Amdahl, the president of that district, does a good job. But he has told us that none of their farmers, not even their best borrowers, can survive on $10 milk, $2 corn, $3 wheat and $5 beans. And as I look at the proposals before the Senate Agriculture Committee, starting with Reagan's, which is a disaster, but going down from there to marketing loan and on down the line—you want to take wheat to $2.40 on the loan rate—and the loan rate's the price of grain; you guys set the price of grain that I receive; you set the world market price for grain with your loan rate. You want to take corn to $1.90, milk to $9.60, and on down the line. If you pass those farm bills, you don't have enough money to bail out the banks that will go down with it, and that's the bottom line on that. And perhaps the St. Paul district would be willing to make that study available to the subcommittee because I think it's very good, some very hard numbers there that show you what it takes for any of their members to break even.

And more than that, before you spend public tax dollars—and I think your law says you have to have a beneficial public purpose to do that—in Minnesota last December, the Farm Credit System held a big meeting at their St. Paul offices, and they were very blunt about it, that they would like to see gone from the system 25 percent of the borrowers who are most at risk. And they succeeded to a great degree in doing that. They went to the FmHA. In my home county, as an example, there used to be 400 PCA borrowers and 100 FmHA borrowers. Today there are 200 PCA borrowers and 300 FmHA borrowers. Every third borrowers is from FmHA. If we did not have FmHA, a third of the farmers in my home county, my friends and neighbors, would not be farming today.

You have a credit system that is structured to handle those problem loans. I think it's doing a pretty good job, and I'm not sure that creating another layer of government through the ACC or whatever level you come up with is going to solve those problems.

That's the end of my testimony, Mr. Chairman. I just think that the solution would be a fair price for farmers; that will solve the system without creating further problems. And if you bail it out, you're bailing out the worst farmers. The loans that go into the ACC are those farmers who bought land at a high price, who expanded when they shouldn't have, who've made some mistakes. They get saved automatically if you set a fair price—not a terribly high price, a reasonable price, cost of production—then those farmers may not ever make it. You can't save everybody, but you will save the good farmers.

What we're asking for now is a bailout of farmers who may not be good managers; and more than that, this is not a proposal to help farmers. This proposal helps bondholders, those who own the Farm Credit System bonds. They are principally banks, and in all of my meetings—and I was with 200 farmers yesterday and 300 the night before and 600 the day before that—I've not yet had one farmer say to me, "We've got to save the Farm Credit System." If the Farm Credit System collapses, it will not adversely affect farmers.

First of all, their interest is too high for the good borrowers; they want to get someplace else anyhow. But for the poor borrowers, they're kicking them out the door. So saving the Farm Credit System will not necessarily help farmers, and if it collapses, it will not hurt farmers. The only people that are at risk here are the bondholders. As a user of the system, I'm not worried about a collapse; but if I had a bond, I'd be scared to death.

This ain't a farm bill; it's a bank bill. It's in the wrong committee.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, commissioner, for your statement. And if you can remain a few moments, after we hear Ms. Smith there might be a question or so that the members of the subcommittee may want to ask you.

Mr. NICHOLS. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. At this time, we welcome Ms. Jo Ann Smith of the National Cattlemen's Association, accompanied by Mr. John Ross, the director. We're delighted you're here, and you may proceed.

Before you begin, let me put the Honorable Jim Slattery at ease. I see he is here now, and he is the only Member of the House of Representatives that has not been heard; and before we begin panel No. 2, Jim, we'll hear from you.

Ms. Smith.

STATEMENT OF JO ANN SMITH, PRESIDENT, NATIONAL CATTLEMEN'S ASSOCIATION, ACCOMPANIED BY JOHN W. ROSS, DIRECTOR, TAX, FINANCE, AND AGRICULTURAL POLICY

Ms. SMITH. Thank you.

Mr. Chairman and members of the subcommittee, I want to thank you for this opportunity to testify on agricultural credit issues. I am Jo Ann Smith, president of the National Cattlemen's Association. On behalf of the NCA, let me commend you for holding these hearings.

Mr. Chairman, you know the statistics of the agricultural credit crisis. Others are presenting information on how agriculture in general is affected; without question, all of agriculture is hurting. Let me focus on how the cattle industry is affected.

We do not know how many ranchers and cattle feeders have been forced out of business due to financial problems, but we do know that the beef cowherd has declined by 3.8 million head since 1982, a reduction of 10 percent. Further, cattle feeding in several key States has declined by as much as 30 percent since 1980.

Our analysts estimate that the cattle industry, as a whole, has lost over $1 billion since January 1, 1985.

Some of our problems over the last 5 years have been either caused or compounded by attempts to solve problems in other sectors of agriculture. Obviously, part of our problem is due to generally poor economic conditions throughout agriculture. Another part is due to changes in consumer demand. We are addressing the consumer demand question, but the credit issue and economic conditions in agriculture must be addressed by Congress. The Congress must recognize the critical financial state of agriculture, and must take steps to address the problems.

There is no single answer, nor any easy answers. Agriculture is facing a massive restructuring. As we go through that restructuring, losses are a certainty; further, agriculture is suffering from interest rates that are 5 or 6 percent above the prime interest rate.

Congress must focus on two issues: One, measures that will reduce interest rates to agricultural producers, and two, measures that will assist agricultural producers and lenders to absorb losses that must be taken, while minimizing disruptions to agriculture. Some farmers and ranchers will inevitably go out of business; unfortunately, that is a fact of agriculture.

The answer will not come from helping just the Farm Credit System or commercial lenders. A number of alternatives must be considered, and a credit package must be developed. This package may include provisions that must be reviewed by other committees, but the leadership must come from the Agriculture Committee.

Among all the ideas that will be proposed, we urge you to consider the following:

One, along with restructuring and increasing the Farm Credit System, regulatory enforcement of Congress may need to provide an infusion of capital to maintain the viability of the system.

Two, increased funding for Farmers Home Administration programs, particularly for loan guarantees, but also for direct loans and interest rate buy-downs. At the same time, Congress must mandate that Farmers Home sell or otherwise dispose of that part of their loan portfolio that is not recoverable. Farmers Home funds must be used to help the individuals who, with some assistance, can cash-flow and survive.

Three, stretching out the time allowed for commercial banks to write off loans.

Four, changing the alternative minimum tax law to remove an unfair tax burden presently imposed on insolvent farmers, as well as changing the tax treatment of loan charge-offs so farmers will not have to pay taxes on these charge-offs.

I am attaching an article that outlines other alternatives to be considered in addressing the credit situation. Let me again commend you for recognizing the seriousness of this credit crisis. You do not have an easy task before you. However, we want to work with you, the other agricultural organizations and the agricultural lenders, to develop programs and policies on agricultural credit. We must work together to relieve the tremendous financial burden that is suffocating U.S. agriculture.

Thank you, Mr. Chairman, again for this opportunity.

[The prepared statement of Ms. Smith appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Ms. Smith.

Mr. Ross, do you have any statement that you would like to make? Or are you just accompanying Ms. Smith?

Mr. ROSS. Just to help with questions.

Mr. JONES of Tennessee. We do appreciate your statement, and I'm sure that the committee will peruse it and take cognizance of the fact that you were here and take a good look at it in the context before we make any decisions.

Any members of the subcommittee have questions for either of the witnesses?

Mr. WEAVER. Mr. Chairman.

Mr. JONES of Tennessee. Mr. Weaver.

Mr. WEAVER. Mr. Chairman, whenever I have a witness that appears before any committee on which I serve that speaks as refreshingly and to the point as Mr. Nichols, I want to just take the time to commend him. It's just a joy to hear somebody who says the truth in this place back here where it's all shadows and deception, and I want to thank you for coming and putting some fresh air into this august establishment. You did a good job. I completely agree with you.

Mr. Volcker was quoted as saying today that the farm credit problems are manageable, is what he said. I didn't see any of the rest of the story. In my mind, there is only one way you can manage the farm credit problems and that's to get the farmer a decent price. And you, Mr. Nichols, said that.

How would you get the farmers a decent price, Mr. Nichols?

Mr. NICHOLS. Mr. Chairman, Mr. Weaver, if you open up to the Wall Street Journal today you will see that the price of corn is set at almost exactly the loan rate. The price of wheat will be the same and the price of soybeans will be just a little bit below the loan rate. You set the price in Congress; I have no control over——

Mr. WEAVER. I can assure you, Mr. Nichols, we can't raise the loan rate. What we can do, as we did yesterday in passing the farm bill—we had budgetary restrictions imposed on the committee; we couldn't raise the loan rate—but we did pass an amendment that requires marketing—if the farmers approve—marketing certificates so you can market just so much grain. And in that way, supply management—putting supply into balance with demand—we will be able to raise the price or get the price to the point where the farmer can make a profit and repay his debts. What do you think of that?

Mr. NICHOLS. You have to have supply management because—the surpluses are what cost the taxpayers a lot of money.

Mr. WEAVER. There's only one way to do that, and that's with marketing certificates, right?

Mr. NICHOLS. Supply management. But you can raise the loan rate. You did it yesterday under Mr. Bedell's amendment, and raising the loan rate is a very cheap way to go.

Mr. WEAVER. Raising the loan rate, but only making sure that only so much of the commodity is grown.

Mr. NICHOLS. It has to be accompanied with supply management.

Mr. WEAVER. Absolutely.

Thank you very much.

Mr. EVANS of Iowa. Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Weaver.

Mr. Evans.

Mr. EVANS of Iowa. Thank you, Mr. Chairman. I also would like to explore a line of questioning with Mr. Nichols, and I am also very appreciative of your testimony.

You talked about treating the symptom and not the disease, and you talked about the fair price and meeting the cost of production, and I agree with you and I supported Mr. Bedell's amendment yesterday and all these things. But here's what I'd like to pursue with you, and that has to do with the cost of production.

In the opening statement this morning, I described what I considered to be a very typical, sound, aggressive, competent customer of the Farm Credit System and his situation. He was relatively conservative in his fiscal management in the late 1970's but now he has a problem because of all the factors that we understand.

If you look at the details of his situation, it's costing him about $1.50 a bushel to meet his land bank obligations. When you're talking about cost of production, and most farmers are, they're including those costs in that cost of production. What they're saying is, "Gee, if I'm going to make all my commitments and pay off all of my debts, I've got to have this price."

Now, assuming we go the route that you would like to go—and I certainly am not necessarily opposed to that; how do we handle the problem down the road? Does that $1.50 a bushel that essentially prices us out of all competitive world markets at the present time, does it permanently stay in the cost of production as we approach it in this country as agricultural policy, or is it something that eventually disappears as we get this debt-to-asset ratio of agriculture as a whole down to more manageable proportions? How would you approach that part of the problem? I don't want to perpetually carry that $1.50 a bushel in corn prices and get it capitalized into the system again, and that's one of the main things that concerns me.

Let me say one thing further of concern along that line. If we were to get that price up to where that person can meet his obligations, how about some of the rest of the producers—roughly 50 percent—who don't have that $1.50 cost, who are going to find that $1.50 coming down to profit and income and who are going to be out there expanding very, very rapidly at the expense of these same neighbors who are having troubles?

These are the sort of concerns that trouble me, and I would be interested in any comments that you have on that part of the problem.

Mr. NICHOLS. I'll try and be brief.

Interest is my No. 1 cost of production. It's also a cost that I cannot control, so it has to be figured into the cost; I can't survive if you don't figure it in.

I would like to see that cost reduced, as would you, and it shouldn't be figured in forever as you figure the cost of production. But in order to reduce my interest costs I have to pay off principal. I'm not making enough money now to pay off any principal; and as loans default in the Farm Credit System my interest rate goes up even though the cost of money is relatively cheap now. So it has to be figured in. I think it will decline as we pay off principal, as we liquidate this $220 billion debt.

Mr. EVANS of Iowa. But you're not necessarily in favor of permanently capitalizing those current costs into agriculture?

Mr. NICHOLS. No; no more than they are in—the farm debt is $220 billion now, and you've got to figure the interest on that as a cost of production. If the farm debt were $100 billion, that would be your cost of production figured in.

Mr. EVANS of Iowa. Then I would say to you—and I guess maybe our only point of disagreement, and maybe it was only one of semantics and rhetoric—is that when we are treating the Farm Credit System problems, we are not necessarily only treating symptoms. I think we are also, to a considerable extent, treating the disease if we do it properly.

Mr. NICHOLS. That's true; but if you bailout the Farm Credit System it doesn't reduce my cost of interest or my cost of production.

Mr. EVANS of Iowa. Absolutely, if we were to do it that way, yes.

Mr. NICHOLS. And the other thing that I wanted to answer, because you asked about the world markets, we are the only Nation that keeps farm prices low and subsidizes farmers. And it's very costly. We produce 8 billion bushels of corn; your State is a major producer. We subsidize the entire 8 billion to export 2 billion bushels of corn. It's far cheaper to subsidize the export of the 2 billion through bonus bushels.

Mr. EVANS of Iowa. Mr. Bedell of our committee has been reminding us of that daily for at least 6 months now.

I yield back my time, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Evans.

Any other member of the subcommittee have a question?

Mr. STENHOLM. Mr. Chairman.

Mr. JONES of Tennessee. Mr. Stenholm.

Mr. STENHOLM. Ms. Smith, you mentioned this in your statement but I'll ask you if you have any additional thoughts on this, and then Mr. Nichols, to you.

Farm Credit Administration has said recently it needs additional powers. You commented briefly on it. My question to you, Ms. Smith, is do you have any further comments on it? And Mr. Nichols, what's your reaction to that request?

Ms. SMITH. We feel that there are some additional regulatory authorities that the Farm Credit System needs that it does not presently have, and we would be happy to further explore that, that there are some provisions and authorities that we think they could use, and wisely.

Mr. Nichols. Mr. Chairman and Mr. Stenholm, the Farm Credit System is asking for additional powers to shift money; that's basically what they want, to be able to quickly bailout troubled spots.

The Farm Credit System was designed very democratically. We elect our local president and on up the line. They are trying to get around that democratically elected process by asking for additional powers. They do not now, in the law, have the power to do that; they have to go to their members before they can shift this money. One way to get around that, the simple way, is to ask you to change the law so they can shift that money easier. If you believe in the democratic process, granting them those additional powers is not something that I would think is right.

They should be able to take that proposal to the membership and sell it; that's the way it was designed. They're trying to get around that. It's an end run on the system, that's all it is.

Mr. Stenholm. Do you believe that that system is adequate to meet the problems we're now experiencing, where you have some credit banks in difficult trouble? We have the loss-sharing arrangement, which the Farm Credit System has put into effect. If I understand your answer, you believe that the present system is adequate.

Mr. Nichols. Yes; I do, and I'll tell you why. Under the present system, the bondholders would absorb some of that loss. The problem is that theoretically you couldn't sell the bonds if you defaulted on some of the bonds. So, instead of the bondholders absorbing a loss in, say, the Omaha district where St. Paul is now shifting money, or the Spokane district, they are taking money from St. Paul and shifting it to Omaha and Spokane and raising my interest rate. It now becomes a self-fulfilling prophecy, that we will all go broke under that system.

I cannot afford 12.75 percent interest on my land, and I have a low-land debt; about $400 an acre, and I have a very good job to support my farm. So I will be one of the survivors. But that interest rate, I cannot control. Theoretically I could control some of it through my Farm Credit System if I could vote on whether or not we should shift money to Omaha. But if you grant them additional powers—and that's all they're asking for, is the power to shift money—you've taken away what control I have over my cost of money.

Mr. Stenholm. One final question to both of you. Do you have a position on the issue of single management in the district banks?

Mr. Ross. Our credit and finance subcommittee met just last week and at this time we're awfully uncomfortable that any consolidation would come about with the support of the local associations; we're awfully uncomfortable that some of the consolidation we're seeing, some of the single management plans we're seeing do not have the support of the local borrowers and the associations. There may be some efficiencies from consolidations, from mergers, and those must be considered. Where there is support for that from the local associations, then by all means those consolidations and mergers should take place.

Mr. Nichols. I think single management would be a good idea. What I've seen in my own local districts, the PCA would say, "I'm not going to give you any money so you can make your Federal land bank payment. We'll stick the Federal land bank." It's an incredible concept going on out there, that we're robbing Peter to pay Paul, and they're the same system. In my own local county we have two buildings, side by side, brand new; one's a Federal land bank building and one's a PCA building, both of them about half used.

Single management is a pretty good idea, but the way they're doing it now is somewhat—they're trying to get around member approval. They're having trouble selling this idea to the members, and it should be done with member approval. That's what the charter calls for.

Mr. STENHOLM. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Stenholm. Does any other member have a question?

Mr. THOMAS. Mr. Chairman, I do.

Mr. JONES of Tennessee. Mr. Thomas.

Mr. THOMAS. I know that for the sake of time we're very much pushed, but I was somewhat disturbed by a couple of Commissioner Nichols' comments here and I want to respond to him a second or two, and maybe get a little further comment from him.

One was a comment that if you did something here to save the land bank, that you were really saving farmers that had invested on higher land values and probably should go broke. I find that a very close parallel to a few comments that were made by a noted agriculturalist, David Stockman, and I think you realize the criticism he came under for that comment.

We have a lot of people who have borrowed around the country in different cycles of time with land values under different pressures, both upward and downward. And I just want to remind you that our best hope of doing anything here, whether it's through the agriculture bill itself—which one was passed out of the House, as you know, yesterday—tackling the credit issue, which must be done, I assure you, on a separate basis altogether—but whatever is done must be done with farmers and farm interests and agricultural interests from across this country coming together in unity. I happen to come from Georgia where there was tremendous pressure put on the farm economy in the late 1970's; it still prevails today by adverse weather conditions and other things, and in fact the State was in a posture of agricultural expansion at the time. It was moving into the era of modern agriculture. This wasn't made by greedy people; it was made because it looked like there was a bright future in agriculture and we had land that we wanted to utilize. Due to pressures and conditions outside of their control, the investments have turned out not to be wise; but it wasn't made out of greed. And I can assure you, it's not in the best interests of any farmer in this country to see another farmer go under, because every time that you do this, you take another chink out of the armor of the whole agricultural structure. You depress land values further. You bring more question into the mind of those who might invest in agriculture in the future or who might lend money to it. You can rest assured that if the land bank system goes under, your cost of money is going to go up; I don't care where you get it from because the risk, the damage done to the whole agricultural system will be incredible.

Maybe I misunderstood some of your comments, but I hope maybe you'll consider what I've said there and think about this. Because you can rest assured that we're either going to hang together in this issue, or we're going to hang separately.

Now, I'll close with one last statement. I'm not about to go in—I have been a serious supporter and also to some degree a real gadfly of the Federal Land Bank System in my part of the country, because I was concerned about some of the procedures that I saw afoot there. And I went personally to the head of the land bank system in Columbia at the time. He is no longer there. I met with the current head this morning, and I've assured them that I do not intend to uphold them in any effort that I don't think is in accordance with all provisions under which the land bank system was established. I won't stand by and support them overriding anything. But they are a part of the credit problem, and we'll pull the whole credit thing together in one sweeping proposal, in my opinion, or we won't pass a bill. I don't think the Congress has the will or the intent to pass something to help land banks alone or Farmers Home Administration alone or private banks, but it's all part of one big credit problem. It is intricately tied together, and if you pull the plug—or if we allow it to go down, an entity which controls $70 billion worth of it—I will guarantee you, Mr. Nichols, that we'll have trouble finding credit for any farmer in this country from any source, in my opinion.

So I just wanted you to understand my feelings about this, and hopefully that you would take my comments and think on them a little bit because it's going to take a tremendous amount of unity in this effort in the days to come and the months to come.

Mr. NICHOLS. I agree with you, and if I can just say one thing on that. The ACC—as proposed, they would take over the worst loans. That's what goes into the ACC. You don't have a great deal of control over those loans; you're simply guaranteeing those bonds.

You probably can't save every farmer, and I'd like to. But I don't think it can be done. But the ACC will kind of do that, at a very high cost to the taxpayers. And it comes back to the Farm Credit System lobbying for two things, a bailout and, in the St. Paul district, the marketing loan bill, which is the Foley bill. And that takes wheat to $2.41 and corn to $1.90 and soybeans to whatever. Under their own study, we cannot survive under those prices. Ask them for the study. Yet they come here and lobby for a bill that will lower prices to a level where they know their best borrowers will go broke, and then lobby for a bailout of the Farm Credit System. I think that's ridiculous, and you will bail them out forever if you do that.

The best way to save the Farm Credit System is to make agriculture profitable. And it will solve itself without building in—saving farmers who perhaps made some mistakes. You will create equity in the system.

Mr. THOMAS. I couldn't agree with you more, and I'll just close with this. It's as difficult to determine as which came first, the chicken or the egg, as to where the problem started and what we do now to eliminate it. But I do insist again that—and I think if I've heard this committee in the past few days, in the past few months—I think the awareness is now here that the credit issue is just as important in stopping this steady, precipitous decline in land values and this mounting of foreclosures that is driving land values further, that something has to be done to stabilize that. I think Senator Harkin put it pretty well this morning when he talked about this. And that, in my opinion, is just as important as doing whatever we can to shore up farm income.

So I just want you to know, I think it will have to be a twofold, two-thrust, two-pronged approach, and I'm not about to try to bail out the land bank or any other one entity. But I have to tell you that somewhere we're going to have to put that stability in there to this credit issue. We've got to stabilize that whole sector, in my opinion, first, though. I give you my assurances that I'm not about to support or advocate some isolated bailout of the land bank system, and I can tell you I don't think this subcommittee is going to do it, either.

Mr. NICHOLS. If I may say, Mr. Chairman, the price of land in Minnesota is directly tied to the price of corn. If corn goes to $2 the land drops another $100 or maybe $200. We paid more than the land was worth; now it will only bring what you can farm out of it. So as prices go down, land goes down. If you want to see the land price stabilized or go up, raise the price of corn. It's that simple.

Mr. JONES of Tennessee. Thank you very much, panel, for your questions and your participation. We appreciate very much your presence and having been here.

Our next witness will be the Honorable Jim Slattery, a Member of Congress from the State of Kansas. And while Jim is taking his seat, I'd like to recognize the fact that a very valued member of our Agriculture Committee is sitting with us this afternoon, the Honorable Larry Combest from the State of Texas. Larry, we appreciate your interest and the fact that you're here with us.

Any other Member of Congress who is here, we would be delighted for you to come and sit with the committee.

Jim, we heard all of our colleagues this morning who were on the list who desired to appear, and we recognize the fact that you could not be here, so you may proceed.

STATEMENT OF HON. JIM SLATTERY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF KANSAS

Mr. SLATTERY. Thank you very much, Mr. Chairman; and I thank the members of the subcommittee for giving me the opportunity to testify before your subcommittee on an issue that I feel is of paramount importance.

During the August district work period, I had the opportunity to discuss in detail various aspects of the agricultural credit system. I met with farmers and representatives of the Kansas Bankers Association, the Federal Deposit Insurance Corporation, the Farm Credit System Wichita district office, the Kansas Bank Commission, Farmers Home Administration, the Federal Reserve Bank of Kansas City, investment banking specialists, and agricultural bankers.

It became obvious that the dimensions of the agricultural credit crisis are indeed staggering. It was the consensus of the group that anywhere from $36 billion to $51 billion in unserviceable agricultural credit existed nationwide. This appears to be substantiated with the results of a study by the Food and Agricultural Policy Research Institute of the University of Missouri that indicates that about 27 percent of farm debt is held by 14 percent of farm operators with debt-to-asset ratios of over 70 percent. This is debt that will probably never be repaid.

For Kansas, the crisis can be expressed in terms other than dollars. It has meant that between January and June 1985, we have seen 319 foreclosures statewide by the Federal land bank.

Many of these cases may utilize restructuring or other money management efforts to avoid the foreclosure, but the rate is still significantly higher than that experienced in recent times. We've had 10 bank closures in Kansas alone; the number of farmers facing liquidation by direct foreclosure or by just giving up is increasing every day. To call the coming months a "winter of discontent" may be a serious understatement.

I am convinced the Farm Credit System will need Federal assistance if it is to survive in the long run. Even though the system has responded with a pooling of funds, it is still vulnerable to a liquidity pinch and we should be worried about its capital structure.

If large loan losses occur in a short period of time so that they cannot be covered by current earnings, the capital would be depleted rapidly.

According to media reports and a brief review of FCS financial statements by my staff, the entire Farm Credit System has about $11.8 billion of capital, but only $6.8 billion is considered primary capital. The rest includes B stock purchases required of borrowers and other types of capital that are considered less stable because they can be pulled out at the farmer's initiative. As of March 31, the system's most liquid asset was $3.4 billion in securities.

This level of limited liquid assets exists at a time when FCS reported in 1984 that Federal land banks had $4 billion in total nonperforming loans. This $4 billion figure included $2.9 billion in other nonperforming loans, plus $1.1 billion in nonaccrual loans.

Under the FCS classification system, other nonperforming loans are ones that have been past due 90 days or more, where exceptional concessions have been made to borrowers for legal or economic reasons, or with severe credit weaknesses. Nonaccrual loans are those in which interest has been suspended because collection of outstanding balance is in doubt, full collection of further accruals of interest is in doubt, or principal and interest payments are in default.

In 1984, Production Credit associations reported $2.4 billion in total nonperforming loans. This included $1.7 billion of other nonperforming loans, plus $637 million of nonaccrual loans. When compared to the $3.4 billion of most liquid assets of the FCS, the $2.1 billion of nonaccrual loans demonstrates the dimensions of the liquidity pinch the system faces.

We must also keep in mind that a portion of the $7.3 billion of other nonperforming loans will slip into the nonaccrual category. However, the experience of the Federal land bank in the Wichita district probably demonstrates the acceleration in Federal land bank losses that can be expected over the next few years. The percentage of Federal land bank volume in nonperforming loans for the Wichita district stands at 10.8 percent, among the highest in the Nation. This figure does not, however, reflect the true condition of the portfolio when you consider that according to Wichita District officials, nearly 23 percent of all PCA and Federal land bank loans in that district have had to be restructured in the last year to prevent them from slipping into a problem status.

This environment points to the need for Congress to address several issues during the coming months.

One, we have got to change the current macroeconomic policy of this country, which is at war with the interest of farmers of America, and, I should add, the national economy. To credibly address our farm problem and our trade problem, we must deal honestly and courageously with the Federal budget deficit. In fact, we need to reopen the budget debate because we just haven't done the job and we need to come back to it and do it right. By doing so, and only by doing so, can we get interest rates down and get the value of the dollar down.

To strengthen the farm economy, we must restore sanity and stability to exchange rates. The overvalued dollar is a chain around the neck of America's farmers, as well as every other import- and export-sensitive industry.

There are two actions we can take to lower the value of the dollar. First, as I said, we can reduce deficits and adopt realistic fiscal policies, and I would recommend this. And second, we must convince the administration to couple deficit reduction with a careful, moderate program of intervention in the exchange rate system. The mere threat of intervention in the exchange rate system, in my judgment, would do a lot to end the speculation that's driving up—or has over the last few years—the value of the dollar.

So, Mr. Chairman, I would emphasize the need to change our broad economic policies to lower interest rates, to lower the value of the dollar, and to strengthen our domestic economy and restore our position of strength in the international marketplace. It is with this belief that I have pursued deficit reduction efforts during my 3 years as a Member of Congress. It is also why I was willing to propose what some viewed as a radical budget reduction package on the floor of the House earlier this year that increased revenues and froze entitlement payments for 1 year to all but those most in need. This proposal would have resulted in a balanced budget by 1989.

Mr. Chairman, we should reopen the budget debate and get the job done.

Second, a comprehensive plan for assuring the availability of agricultural credit must be addressed. I call upon the FCS task force to submit its recommendations to Congress as soon as possible for a review. However, we must guard against this effort becoming a bailout for Wall Street and institutional investors in the name of assisting family farmers.

I would observe that the financial stability of the $75 billion Farm Credit System is far more important to our Nation and to the financial stability of our financial institutions than Chrysler, Lockheed, Penn Central, and Continental of Illinois.

Third, we must not allow the wholesale transfer of land that comes into the holdings of the FDIC, the FCS, and Farmers Home

Administration to nonagricultural hands. Farm families that previously owned the land must be provided the opportunity to rent or repurchase these properties.

Fourth, the various agencies and representatives of the agricultural credit system must do a better job of working together to utilize limited resources. At the meetings that I held in my district, I was frankly alarmed to learn that some of the people involved had never met each other before. It was absolutely amazing, and I would say that that's probably true across the country, too. FCS must be talking to the Farmers Home Administration; FDIC must be talking to both the private sector and other Federal agencies.

Fifth, credit assistance must be extended to restructuring real estate debt in addition to nonreal estate debt. Farmers, lenders, and rural communities would benefit from programs that would prevent a glut of farmland on the market, thus depressing land values far below their economic worth.

Sixth, the Commodity Credit Corporation is another source of farm credit. I would encourage the Agriculture Committee to preserve an annual limit on nonrecourse loans, sufficient to preserve farm income, with only recourse loans available above that limit rather than a very low cap on loan payments. Such a nonrecourse loan cap serves to direct loan benefits to true family farmers.

Seventh, we must recognize that it will be very difficult for the 90,000 to 100,000 farmers with debt-to-asset ratios of more than 70 percent to continue farming. In order to ease the adjustment of these displaced farmers into a new vocation, a comprehensive program of retraining and relocation benefits must be a part of the package of legislation developed by Congress to address the credit crisis.

Mr. Chairman and members of the subcommittee, I thank you for your indulgence, and I know you've heard an awful lot of testimony and you're probably anxious to get on with the rest of your schedule today. I'd be happy to answer any of your questions, and again I thank you for the opportunity to be here today.

[The prepared statement of Mr. Slattery appears at the conclusion of the hearing.]

Mr. **Jones of** Tennessee. Thank you very much, Jim, and we're going to forego asking you any questions as we did other Members today, but we'll have the privilege of talking with you in case need be before legislation is improvised.

Mr. **Slattery**. Thank you very much. I appreciate your leadership on this issue, too.

Mr. **Jones of** Tennessee. And we appreciate very much your participation in these hearings, and I'm sure we'll be in touch with you.

Panel No. 2, will you please come to the witness table. Mr. Bob Hendrix, Dyersburg Production Credit Association, Dyersburg, TN; Mr. Clif Cobb, Rolling Plains Production Credit Association, Rolling Plains, TX; Sam Lester, Southern Middle Tennessee Federal Land Bank Association, Murfreesboro, TN; Mr. Allen Olson, a farmer of Winnebago, NE; and Mr. Arnold Wienk, a farmer of Lake Preston, SD.

Let me tell the witness list, the witnesses who are there, that we pleaded with you to do your very best to remain in the 5-minute rule as far as your testimony is concerned; and when we are finished, if there are questions to be asked by members of the subcommittee, we'll take that privilege after we've heard all the members at the witness table.

The first witness on the list is a gentleman that I want to present because he's from my congressional district, a personal friend of mine, and the president of the Dyersburg Production Credit Association and many other titles and good things that I could say about Bob Hendrix that I will let go because of time. I think he's a gentleman who has some expertise in this field of farm credit, and I think that he can lend to this committee some wisdom that we need. And with that, Bob Hendrix, we're delighted that you're here and you may proceed.

STATEMENT OF ROBERT M. HENDRIX, SR., CHAIRMAN, BOARD OF DIRECTORS, DYERSBURG PRODUCTION CREDIT ASSOCIATION

Mr. HENDRIX. Thank you, Mr. Chairman, other members of the Agriculture Committee. I am Robert M. Hendrix, Sr.; I've been a farmer all my life, and I have served on the local production credit board of directors for 24 years and am presently chairman of the board. I have served on the national advisory committee representing production credit associations throughout the United States for about 10 years. I was chairman of that committee for 3 years during the 1981 farm legislation effort. Also, I have served on the Louisville farm credit bank board for 6 years as district director. I also served on the board of directors for the farm bank governing body in Denver, CO. I am here today representing a grassroots farmer who believes that agriculture, as far as being a profitable venture, is at the crossroads.

During my time in serving on the local production credit board, I have seen an association grow from $13 million to a peak of $127 million in 1981. During this time, the association loaned $1,229,920,754 and only suffered losses of $382,000. From the year 1981 on, when farm economy began to falter, the associations in our area have suffered substantial losses, but I do not believe that this is because of bad or poor credit administration, but because of poor prices for farm products.

Many of the loans that we have seen today that have become problem loans showed, at the time they were made, that there was a profit margin and that they would pay themselves out as they had always done. But due to the farm prices that our members were getting for their products, there was no way that a person could pay the high interest rate and high input cost and have a profitable operation. I know that examples can be pointed out where through conservatism or other methods, some people have held their operations together through these times, and some of them even shown a profit. But I am talking about the average member-borrower that we have in our association that has been put into these predicaments through no fault of their own, that can no longer cash-flow their farming operation. We have had many, many young farmers who were just getting started in farming, who have had to sell out because they could just not make a living under present conditions. The average age of the farmer today is 54 because young farmers educated in the field agriculture have left the farm and will probably never return again. The prices of commodities and the price of land have caused other members to have forced sales. This has brought the price of land down until it will not pay the interest and other upkeep costs.

Considering all of these things, we do not see much hope for the future of farming. I believe that the thing that has made the farm credit system so great and profitable for farmers is having grassroots input into the operation of the association and farmers' feeling that they are owners of the system and proud of their organization. Recent news media articles indicate that local boards of directors who are elected by grassroots members that own the system are a hindrance to the system. I think a good parallel of this would be Members of Congress who never paid any attention to the people who elect them. This would be like letting the President run the whole show without a Congress; and gentlemen, we know that this is not the way a true democracy or a cooperative works. Gentlemen, I ask you, where would we be today without you?

I believe the thing that has made American agriculture great is the right of individuals to think and plan for themselves. We find ourselves in a situation today where the associations are being asked to put all their capital into a consolidated structure. This is capital that has been generated for use by the membership, and it belongs to them. If this capital is pooled for one association, we're told that the equity can never be returned to the members. I believe there should be some way, when and if this situation turns around, that we would be able to bring that capital back into the association where it belongs.

Cooperatives as far as the local board of directors, lose complete control of an association or representation of its membership on a board of directors when things like this happen. I know that we live in a changing world today, and I know that the methods of financing agriculture must change also, but I have to think that when an individual farmer becomes a number in a computer, and the computer decides whether or not he is worthy of credit, we have lost what we are about. Many examples have been shown that some associations were lax in extending credit. But I think if you look at the commercial banks that have been dealing with agriculture, you will see that if this is true in the farm credit system, it certainly is true in the commercial banking system. And their rules, according to recent articles, are much stricter in administering credit than ours. Yet until 1981, they showed a much greater loan loss from the amount of dollars loaned than the farm credit system, a total of 2.5 percent annually. The present Bankruptcy Law of 1979 has caused a tremendous cost to farm credit lending institutions and to the association members. Many members facing workout loans find that chapter 11 of the bankruptcy laws give 2 more years to drag out a loan. This is an added cost, not only to the lenders but also to other members. It would be interesting to know the actual cost to lending organizations in comparison to the number of farmers who have been able to survive this route.

Lenders need help as well as farmers. Give farmers a chance to make a decent profit on products they produce, and problems of lending institutions will also be manageable. We do not need more credit; we need a means to pay for the credit that we now have, such as increased commodity prices. I don't know how this can be brought about, but I do know that farmers in other countries are subsidized for their farm products in order to have a decent profit to continue to live on the land because these countries realize that agriculture is the most important asset they have. And I believe this is true in America today. Agriculture is the greatest asset we have. And yet it appears that agricultural support has been put on the back burner, as far as priorities within this Government. This present administration is concerned about foreign policy, help to Guatemala, and other countries. These things take priority over helping our own people at home. I believe this is wrong. I believe that if a united effort were put forth by the Congress of the United States to, by some means, feed the hungry and take the surplus products that we have on hand and get them to the people who need them or trade farm products for oil, we could see our profits and our markets increase.

The American people spend less of their disposable income for food than any nation in the world. If the plight of the American farmer is allowed to continue, it could get to a point where we could put the American farmer out of business. There is one thing that everyone does every day, and that's eat. And the American farmer is the source of that food, and we need to keep that in mind.

I know this committee has many problems to deal with, but I feel this is one of the most critical ones at this time and should be dealt with as soon as possible.

Thank you for the privilege of appearing before this subcommittee.

[The prepared statement of Mr. Hendrix appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Bob Hendrix, for a good statement. We will reserve the right to ask you some questions when we have finished the panel.

I yield to my good friend and a member of the subcommittee, Congressman Charley Stenholm of Texas, for the purposes of an introduction. Charley.

Mr. STENHOLM. Thank you, Mr. Chairman. It is indeed my pleasure to introduce the next witness, a longtime friend and my banker, Clif Cobb of the Rolling Plains Production Credit Association of Stamford, TX. Clif has been in that position for quite some time; he has been, as I said, my banker through some good times and some tough times, and it's a real pleasure for me to have this opportunity to introduce you, Clif, and also recognize Bill DeBusk, I believe one of your board members, another cotton farmer from our area, very interested in this same subject, out in the audience.

Without any further ado, Clif, we'd like to hear from you.

STATEMENT OF R.C. (CLIF) COBB, PRESIDENT, ROLLING PLAINS PRODUCTION CREDIT ASSOCIATION

Mr. COBB. Thank you very much, Charley, for that introduction, and Mr. Chairman. Since Charley has already identified who I am, I'll not repeat that. But on September 15, 1985, I will begin my

47th year with this association. I have also been a stockholder of the local Federal land bank association for the past 30 years. For these reasons, I have a deep and abiding interest in the welfare of the Farm Credit System as a whole.

We deeply appreciate your concerns about the economic health of the Farm Credit System as evidence in the scheduling of these hearings. My formal statement will be concentrated largely on the provision for loss formulae we have been required to conform with since 1949. This and earned surplus accounts constitutes the very lifeblood of production credit associations. In the March 1985 issue of the Farm Journal, Senator John Melcher, Democrat of Montana, is quoted as follows:

> In my 16 years in Congress I have never had to get into the day-to-day operations of the Farm Credit System. They always seemed to have their business in order. But this experience points out there is not much depth to their reserves.

I am sure each of you shares these feelings and have made similar observations in recent months.

Recent news releases quoting FCA Governor Wilkinson have confirmed the above, notwithstanding firm positions to the contrary just 2 months ago.

The board and management of Rolling Plains PCA has been distressed about this subject for many years. The board has studied and discussed the annual and maximum provision or allowance for loss formula in depth with increasing frequency during the past 10 years. The results of these discussions and studies have been documented in position statements on numerous occasions. Unfortunately, we have been unsuccessful in getting proper attention focused on the issue by those in position to take proper action.

In this presentation I will attempt to show the following: One, the legal history of this point in the law; two, the Farm Credit Administration's administrative policies on this issue; three, efforts of Rolling Plains PCA to obtain recognition of problems associated with administration of the law; and four, recommended procedures in the future.

It is generally known that the Farm Credit System was originally capitalized with Federal funds. Production credit associations were exempt from Federal income tax so long as any Government capital remained in an association. Rolling Plains completed payment of that capital in December 1948 and therefore became subject to Federal income taxes in 1949.

Prior to 1949, and for a few years afterward, valuation reserves—or provision for losses—were arrived at rather subjectively. Section 22 of the Farm Credit Act of 1933 provided for the "creation and maintenance of a reserve account for bad and doubtful debts, the amount of which account shall be prescribed by the Production Credit Corporation." The Production Credit Corporation was later merged into the FICB, supervised by PCA operations at that time. In 1950 the question was studied to arrive at a formula adequate to cover risks and to be consistent with the legal mandate in effect then.

The Production Credit Corporation of Texas determined that annual additions of eight-tenths of 1 percent would be made, with a maximum provision of 4.5 percent. Accordingly, under PCC influence, the association board on September 22, 1950, reluctantly adopted a resolution to use this formula. At the same time, the board felt very strongly that it was grossly inadequate, particularly in view of the natural hazards involved in agriculture and agricultural lending. Losses sustained following the drought years of 1951, 1952 and 1956 proved these fears to be correct.

On October 3, 1961, the Farm Credit Act of 1933 was amended to provide for "valuation reserves against loan assets in an amount equal to one-half of 1 per centum of loans outstanding at the end of the fiscal year—until such reserves equal or exceed 3.5 per centum of loans outstanding at the end of the fiscal year beyond which 3.5 per centum further additions to such reserves are not required but may be made."

Section 2.14 of the Farm Credit Act of 1971, replacing previous statutes, repeated the language of the 1961 act, as quoted above, on provision for losses for PCA's.

In January 1977, nearly 9 years ago, we began documenting our distress and anxiety about the inadequate provision for loss prescriptions. The following is extracted from a statement identified as exhibit A to this testimony, adopted by the association board on January 14, 1977:

> It was the general feeling that risks inherent in agricultural lending are constantly increasing. This is due to a consistent and steady increase in size of operations, with investment requirements and expenses increasing in the same or higher ratios.
>
> In past years when there were more agricultural operators, with smaller operations and liquidation of a loan was required, any deficiency could frequently be covered by other assets or pledge of future income. With increased average lines of credit this becomes more difficult or impossible, thus increasing the potential risk.

Then the very next month, on February 11, 1977, an additional statement was made on the subject, and excerpts of the board minutes of that date are attached as exhibit B. But one very brief paragraph quoted from that:

> It has been extremely gratifying to observe the numerous examples of success resulting from finance provided by the association in recent years that could have become credit problems in a period of 2 or more years of adverse weather and price conditions. Since they are the beneficiaries in the cycle of favorable conditions, it is believed they should have contributed more than the one-half of 1 percent to the provision for losses.

In studying and commenting on capital conservation and loss sharing plans being proposed, a lengthy board position statement on December 16, 1977—further excerpts of that statement attached as exhibit C to this testimony—which included the following, has proven to be somewhat prophetic:

> A confederation or alliance of all associations within the district in a capital conservation or loss sharing plan possibly would be desirable if the basic problem of higher individual association provision for losses were solved first. Rationally, it does not seem proper that a number of small problems would be solved by creating one large problem.
>
> If conditions outlined in this statement were to develop, few if any of the associations in the district would be financially able to contribute to a loss sharing plan. Again, this board maintains it is urgent, and long overdue that the present antiquated formula for building and maintaining provision for losses be revised to recognize the extremely high risk involved in current agricultural lending.

On January 18, 1979, when the loss sharing plan was finally sold to the district by the Federal Intermediate Credit Bank of Texas, through pressures from the Farm Credit Administration, the association board again recorded its displeasure with the concept. A portion of this statement is quoted as follows, with the major part of it attached as exhibit D. And in that statement we said, among other things:

> We wholeheartedly agree that investors should be protected, but we do not believe the loss sharing plan is sufficient within itself to accomplish this. If associations become unable to make contributions to it when called upon, a vault full of adoption agreements will be of little benefit.
>
> We reaffirm as forcefully and positively as we know how that risks inherent in agricultural lending in this area have increased many fold since 1955. The inelasticity of formula for building and maintaining provision of losses should be changed to permit more flexibility where greater perils exist. Although losses have been modest in the last 23 years, this is not a true indicator of the cyclical hazards involved.
>
> To permit an association to become insolvent due to inadequate provision for losses would be somewhat analogous to the epitaph on the tombstone that read, "I told you I was sick." We plead that preventive medicine be practiced now. If this is done, the loss sharing plan might not be needed, and if it were, there would be some substance to support it.

There continued to be inattention to the problem, and on October 29, 1982, the association board adopted a statement some 12 legal-size pages in length that summarized some of the previous positions, took note of significant recent developments, and again forecast the circumstances that have now transpired.

In the above statement we affirmed that supportive loss record existed then in many associations to permit higher provision for losses, and that immediate action would be tardy at best. If not, we wanted to know how many associations must become insolvent and how much loss must be sustained to provide a supportive record for a change in its administration.

We were convinced then that we could negotiate a more favorable formula with IRS if FCA would have supported us. However, we did not feel the outcome would be favorable for us if FCA took a position against us, or even if they remained silent.

Our own association's history supported these fears. We have maintained through the years that accrued interest receivable on loans should be included in the calculation of annual and maximum additions to the provision for loss account.

We were convinced also that it was permitted in laws referred to previously, which stated that the calculations were to be on loan assets, and we thought logically included accrued interest receivable. In 1974 we consulted with our tax accountant on the question and were advised to include it in the calculation. He further advised that inclusion of accrued interest receivable was more reasonable and defensible before IRS than using loan principal only as it was an added debt burden to liquidate.

With this support we filed our Federal tax return accordingly for the 1974 tax year. On the next FCA examination it was listed as an exception, but we were not told to refrain from the practice. For the 1975 tax year we followed the same procedure. After the next FCA examination, we received a letter from the FICB of Texas which left no doubt about FCA's position, and that we would not repeat the practice.

It was indeed gratifying when the FCA, on December 12, 1983, ruled that accrued interest receivable could be included in these calculations, as we insisted could be done in 1974.

It appears that I'm using up my time, Mr. Chairman. Should I proceed or——

Mr. JONES of Tennessee. Proceed until we know whether we have to go vote or not. Go ahead. I'll call you, Mr. Cobb, if we have to go; I'll just ask you to refrain if we have to.

Mr. COBB. I have a bit more that I would like to present if it would be in order. Thank you, sir.

Mr. JONES of Tennessee. Go right ahead.

Mr. COBB. The October 1, 1982, statement drew comparisons between commodity and livestock prices of July 1952 and July 1982. With a few variations, almost everything the farmer or rancher sold in 1952 was only slightly above or below parity. In 1982 almost everything was approximately one-half of parity and has deteriorated even further since then. Obviously, this accounts for the magnitude of the problem today and serves to champion the cause we have desperately tried to focus attention upon. While comparisons with parity may have lost some of its validity during the years, it nevertheless points out the basic problem very vividly.

The October 1982 statement concluded with the observation that "preparation for the circumstances that now confront us should have begun at least a decade ago. Today may be too late."

Then in December 1982 and May 1984, we went on record again with similar thoughts and statements. The effect of all of this is that figuratively we are required to walk across a river 100 feet wide which averages 3½ feet in depth. However, if about 30 feet of the span is 7 feet deep, many PCA's will drown in their attempt to negotiate it. Yet, the current view is that you should not drown, for after all the water only averages 3½ feet deep, and if you even come close to going under, all kinds of sanctions will be invoked. Then management, whose hands have been tied for years, is held fully accountable. If we could program our losses so they would come annually, the survival rate would be higher. However, when all our loan portfolio is concentrated in agricultural enterprises, loss provisions must anticipate the depth of the water at its deepest point, certainly not its average depth.

Generally accepted accounting principles recognize the above, as these principles require an allowance to cover estimated losses in the loan portfolio. However, our accounting and annual financial reporting have pointed out consistently that it conforms with GAAP, except with respect to the accounting for allowance for loan losses.

We believe loss provisions must be in accordance with GAAP, and due to the concentration of the portfolio in agriculture with its related hazards, any provision up to 7 percent in PCA's should be permitted. Then the annual addition should be flexible enough to comply with GAAP.

A recent policy statement, although tardy by about 10 years, by FCA on this question is indeed gratifying in some respects. However, bank and association management may suddenly be held accountable for GAAP in this financial area without having the opportunity to apply its principles during the period in which building and maintaining adequate loss provisions could have been made more easily.

I will conclude this portion of my testimony by observing that if proper attention had been given to the above during the past 10 years, the Farm Credit System would not be undergoing the scrutiny and rigors it is today. Admittedly, some district banks who lost sight of sound credit principles and certainly some associations would have failed even with these preparations, but the preponderant number of others would have had financial strength to support them. If these preparations had been made, pressure for mergers of PCA's would not be so widespread. The System, as a whole, would have been in much better position to ride the cycle to the bottom, then start with a fresh beginning.

As it now stands, we are being called upon to lend support all over the country when all our resources are needed locally. In some quarters, any reluctance to do so is described as a "parochial" view. When an association has closely monitored expenses, made frugal decisions on its investments in office buildings, maintained as good credit quality as possible and built strong surplus accounts with aftertax dollars, it is hard to get excited about mergers and other dilutions of capital. Quite naturally, they are scrutinized very closely. Notwithstanding these considerations, we stand ready to assist elsewhere to the extent we can without jeopardizing our own economic health, but there is a limit to the number of times you can donate at the blood bank. It is too good a system and too valuable to the Nation's agricultural economy to allow it to fail. Surely it is worth as much to the Nation as one of its major commercial banks.

There are many issues of current interest I would like to address if time permitted, but would like to touch very briefly on a few.

The "at risk" feature of association class B stock has become a major issue. As it now stands, it cannot be denied that it is subject to impairment. The engagement of outside auditors and the overkill consequential to it by them and FCA can throw the whole system into an uproar. Facts need to be disseminated, but 10- to 15-page disclosures would be so cumbersome they might do more harm than good.

Since class B stock investment is a requirement for obtaining a loan, and if the "at risk" aspect is to be strictly enforced, some method of ensuring this risk should be devised. If the investment were optional, there would be basis for risk exposure, but since it is not, risk can only be avoided by refusing to accept the loan. This will become a greater obstacle in the future in new business development. As we understand it, on this issue, there have been different policies followed in liquidation or reorganization of PCA's in different farm credit districts, which spotlight the need for insurance to assure consistency.

It seems to us in the country that little consideration is given to the impact that various FCA directives and policies have upon the borrower. Implementation of some of these tends to make larger borrowers very wary, and is eroding confidence that has been built through the years in the System.

Currently, an area in which FCA seems to be extremely zealous is designation of persons authorized to vote stock owned in an association. For over 50 years, this has been no problem, and all of a sudden, it becomes a major issue. Again, no consideration seems to have been given to the effect all these administrative requirements have upon the individual stockholder.

Several years ago, a system of borrower surveys was begun for statistical purposes. Initially, it began with a small sampling and has increased in scope until in 1986 it will be required on every loan made. The goal was to progress to the point where it could be computer generated, but that method is still somewhat in the future. In the meantime, gathering and reporting this information will be virtually as time consuming for our staff as the loan applications themselves. In addition, many precautions must be made and certain expenses incurred to safeguard confidentiality of the information reported.

The intent of the truth in lending law is good and serves a useful purpose. However, for anyone as highly regulated as the Farm Credit System, there is no way we can violate the spirit of it, yet disclosure requirements add extensively to our administrative burden. Some method should be devised whereby our examiners could check us for compliance and, if found out of compliance, impose penalties. Our borrowers are totally unconcerned with the completion and receiving of this information, and it constitutes a wholly unnecessary burden for them and us.

We support the single management concept at the district bank level and believe it will be a constructive step forward when permitted to operate independent of the present shadow of legal action in our district. Indications are that progress is being made despite this. We have many friends in land bank associations who feel otherwise, and we respect their opinion as we trust they will ours.

On this issue, we believe the overall credit needs and flexibility of its administration, for the average farm or ranch operator, is overlooked. We could list many reasons for holding to the position, but time does not permit.

We will continue to support the tax exempt status of the Federal land bank and Federal land bank associations. Although at times it is surprising to some familiar only with FLBA operations that a comparatively small organization like Rolling Plains PCA has paid in excess of $1.7 million income taxes in the past 6 years.

During the first 30 years or so of the existence of the production credit system, I, along with many of my contemporaries, worked with almost evangelistic fervor to advance and promote the PCA concept of agricultural lending. With all the unyielding policies, rules, and regulations imposed in recent years, there has been an obvious change in attitudes of officers and employees at all levels of the banks and associations. Loyalties that once existed have diminished somewhat, some of which may be attributed to sociological change, but certainly not all. We believe there should be a general review, with genuine input from banks and associations, of existing policies and regulations and how they are administered, to determine their effect on employee morale and the resulting impact of the entire system.

Through the years FCA has countered these arguments with many reasons why proper loss provisions cannot be made. Yet, the things we warned of have transpired. Since we work with these problems on a daily basis, we thought we were in a better position to relate to them than those far removed and insulated from them.

The balance in provision for loss account in PCA's in large measure dictates lending policy, whereas conservative lending policy should be adhered to with provision for losses maintained in keeping with risks identified in that portfolio.

Even though we have long predicted it would happen unless we were prepared for it, we gain no satisfaction in the announcement made by Governor Wilkinson as quoted in the Wall Street Journal, September 4, 1985, that the System "cannot absorb the losses we face." The secondary market in FCS bonds has made a rather dramatic change during the past few days as a result of the adverse statements of last week. For example, on Friday, August 30, 1985, bonds with a maturity of September 1986 were trading to yield 8.02 percent. On Thursday, September 5, trade prices would yield 8.64 percent. If these differential prices continue to prevail, it will create an additional large economic burden on Farm Credit System borrowers. In the same period, there was no appreciable change in the secondary market on other similar bonds. When problems arise, it is usually accompanied with finger pointing. There will be charges of lack of legal administrative authority to control all the various banks and associations. However, the fact of the matter is that those isolated from the battlefield refused to see it coming and would not listen to warnings of those who could.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Cobb appears at the conclusion of the hearing.]

Mr. **Jones** of Tennessee. Thank you very much, Mr. Cobb.

Our next witness is a gentleman that I've known for a long, long time in the middle portion of my State, Sam Lester, president of the Southern Middle Tennessee Federal Land Bank Association in Murfreesboro, TN.

Sam I appreciate the fact that you could take the time out to be with us today, and you may proceed with your testimony.

STATEMENT OF SAM LESTER, PRESIDENT, SOUTHERN MIDDLE TENNESSEE FEDERAL LAND BANK ASSOCIATION

Mr. **Lester**. Thank you, Mr. Chairman.

It's my pleasure to be here. I appreciate the opportunity. I'm a dairy farmer and grain farmer from Murfreesboro, middle Tennessee, and I've farmed all my life and have made a pretty good living at it in the past. But today it's pretty hard to cash-flow this operation any more.

I've served on the land bank board for some 23 years and have been chairman for the last 10, and I never believed that I would see this System come to what it has come to now. In fact, I was in Washington here a month or two ago and I told someone at the FCA that I don't believe they could have hired a firm to cause an organization to come to its demise such as had taken place in raising interest rates.

I recall in 1934 my dad came home from town one afternoon, and he had gotten a land bank loan. He'd had problems for several months there with the local bank pressuring him, and he'd finally gotten the land bank loan. He sat by the open fire that night, and he had a different attitude altogether, and he was just so happy.

And we popped popcorn and he told us that this was the System, this was the bank that would stay with you through thick and thin. Well, we don't necessarily see that happening today.

Yesterday afternoon I was working in my shop there and a young man, a farmer down the road, stopped by. He had just come from the co-op, and of course we have a fairly good-sized co-op there. In the past we've been able to handle our farmers' grain because we fill our bins and then we're shifting it out to railcars all the time and sending it on to other places. But they had informed him yesterday that they would not be able to handle his corn because they had already contracted all the corn they could use, and there was no place to ship it. I mean, we can get the railcars, but where are you going to ship it? Certainly not to Indiana and Ohio.

So this boy wanted to know—he's got a land bank payment due next month, and would he be able to pay his land bank payment in corn? You know, when you think about it, it's pretty serious. We don't have the bins built at the land bank yet, either.

We are certainly opposed to the one-concept idea of moving this banking system into one big association because we know that we need to have local input and grassroots support for the system. We don't mind the part of the loss sharing agreements. We feel that it is necessary that we help save our system. But when we talk about taking all the money from those who have had very good operations and who over the years have not indulged in big land price deals, to take that money from them and give to those that did that would be amiss to us.

I think that one thing that needs to be thought more about in this situation is, we keep talking about the farmers and the bailout of the farmers. But to me, in my county of Rutherford, a county in Tennessee, we have a Nissan plant; that's a great big Japanese automobile plant, and we're still No. 1 agriculture. We now have a Saturn plant coming pretty close to us, and we're still going to be No. 1 agriculture—that is, if there's a market left.

But I started down the street the other day, and I looked at the Heritage Farm milk plant, great big modern milk plant, 40 big trailer trucks going in there in a day with milk, they've got 18 wheels, fuel running through them bigger than your thumb all the time, 60 coming out every night going to 12 States. Go around to the Courier, and they employ 100 people and all those drivers. You go around the corner there and you have Paramount Packaging, make all the packages for the bread wrappers in the Southeastern United States. I can tell you this, each one of those wrappers is about 23 cents, which is about five times of how much wheat I've got in that loaf of bread. But then you go on to Rich's Cake Place, and you go—and what I'm trying to say is that this is not just a problem for agriculture. This is a problem for about one-third of your whole economy, just involved in agriculture.

I appreciate very much the opportunity, Mr. Chairman, for coming to be with you today, and thank you much.

Mr. JONES of Tennessee. Thank you very much, Sam, for that statement, and we do appreciate your presence today.

Our next witness is Mr. Allen Olson, a farmer of Winnebago, NE. Mr. Olson, we're pleased that you're here, and you may proceed.

STATEMENT OF ALLEN OLSON, FARMER, WINNEBAGO, NE

Mr. OLSON. Thank you, Mr. Chairman, thank you very much.

They pulled a kind of sneaky on me; about 12 o'clock they called me and told me to be down here at 2 o'clock. I was packing up and getting ready to go home, and they told me I was supposed to testify, and I didn't know what for, but I came down to see.

I've been traveling with a team of horses from Nebraska; I started out the 29th day of June and arrived here the other day, and I wanted to find out when I left home if all of the farmers across Nebraska were in the same position that they were in our county back there. The people in our county back there—and the bankers have told us that it was just an extreme case, right here in this corner of Nebraska—I wanted to find out first-hand, so I started out with a team.

When I got into Iowa the first placed I stopped, they had the same thing. They said it was just a small area here in Iowa where there was a farm crisis. I came to the next county; the next county was the same way. I asked them in that county how bad it was, and they said, "Just in this county; no further." It went on that way all across Iowa, people losing their farms, farmers talking to me, telling me their troubles.

I asked them what they wanted to make ends meet. They said, "All we need is higher prices, and better product overseas, but cheaper interest. If they give us that, we will survive."

I traveled into Illinois and asked them what their trouble was: "We haven't got nothing for our commodity. Our prices are too low." We got into Chicago Heights, IL, with the team of horses, and the people down there said, "Farmer, go get 'em; we're starving to death here."

It's been rather interesting for me to know that I'm not the only one. Rural America is suffering all the way, and all the farmers are asking for is cheaper interest, a higher price for their products, and a better product overseas. And if we get that, we can survive, I think.

I heard a gentleman here earlier this afternoon say that some of the farmers had bought high-priced land, and that's why they're in trouble. But through my travels I haven't found very many that have done that. I myself was a farmer; haven't bought 1 acre of ground, haven't expanded since 1947. I farmed 1,200 acres. And from 1980 on down I've been going downhill.

But besides that, I think we could save her if we could just get cheaper interest and a better commodity overseas and higher prices for our products.

This has been kind of an experience for me that will live a long time in my life. I think I'm about running out of things to say, so I'd probably better quit.

I've enjoyed it all, and thank God that I got to say my piece, anyway.

Mr. JONES of Tennessee. Mr. Olson, we appreciate more than you know the fact that you took the time out to be with us today. Not only do we enjoy these hearings, we learn a lot too, and we try to pass it on to our constituents and to the people that are affected.

The final witness on panel No. 2, as far as I know, is a gentleman from one of our subcommittee's home States, and at this time I yield to a very valued member of the subcommittee, Hon. Tom Daschle.

Mr. DASCHLE. Thank you, Mr. Chairman.

I think this has been a very informative panel. We've heard from Texas; we've heard from Tennessee; we've heard from Nebraska.

We're about to hear from a farmer who has been a farmer for 30 years in the eastern part of South Dakota. He's got a great deal to share with us. He came all this way; he'll be going back to South Dakota tomorrow, and I know I speak for the whole committee in welcoming him and expressing our gratitude to him for taking the time to be with us this afternoon.

Arnold, please proceed.

STATEMENT OF ARNOLD WIENK, FARMER, LAKE PRESTON, SD

Mr. WIENK. Thank you, Tom.

Mr. Chairman, members of the subcommittee, I am Arnold Wienk from Lake Preston, SD. I have farmed on my own for approximately 30 years. My wife and I have five daughters, two of whom, along with their husbands, are partners in our family farming operation. We operate a livestock and grain farm that my father had originally purchased in 1936. We have also had a purebred Charlois herd for the past 28 years.

In 1976 I joined the PCA at Watertown, SD, in order to get financing for our operation. As the sons-in-law joined in the operation, they also joined the same PCA.

The last few years, especially since the high interest rates of 18 to 20 percent during the early 1980's, have resulted in a substantial decline in the financial situation of farmers. The last 2 years, because of the deterioration in the net worth of Federal land banks and PCA's, the resulting high interest rates are contributing to the decline in family farms. My net worth has declined immensely just with the stroke of a pen. This is not because of poor management or because I did anything foolishly or had any crop failures. The financial institutions have devalued our land and other assets so bad that it is multiplying the size of the problem and forcing more and more family farmers to leave the land.

The PCA's have gone to different rates of interest. These interest rates are highest for the farmers and ranchers with the highest debt-to-asset ratios. The PCA's were originally established as co-ops to treat everyone equally. This is not the case now, as they are trying to break the farmer with the highest debt loads by charging him higher interest rates. The Federal land bank, which we have also borrowed from, also has gone to a two-rate interest system.

This spring we got notice that our local PCA had frozen all existing B stock. B stock is money that is borrowed to finance additional loans. If I borrow $100,000, I must also borrow $10,000, or 10 percent more, to purchase B stock. Before this spring, if you paid off your original loan, you no longer had to pay interest on the B stock. In effect, the B stock was also paid off. Now, however, B stock is frozen and principal payments do not reduce the amount of B stock. B stock that was an asset on a financial statement is now a liability. If I paid them off completely, I would still have to pay interest on the B stock. If I wanted to get my finances from another credit source, I would have to pay for the B stock before my assets could be released.

Our local PCA directors had no say in this decision. They received a letter from Omaha announcing this directive. I have two good friends who are directors on the Watertown-Northeast PCA and they tell me that they have no say in decisions made regarding our own local PCA. This is not how our PCA's were originally organized. They were not consulted at all. This uncertainty about our B stock and these variable interest rates creates increasing mental anguish as to one's finances and what the future holds.

And also, because of insecurity in the Farm Credit System or whatever, I have had four different loan officers in the last 9 months, and it's pretty hard to run a farming operation with a different loan officer every other month because you have to get confidence in him and he has to get confidence in you to learn what you're trying to do.

The decline in net worth has stopped most farmers from replacing equipment as they should. This is causing farm equipment dealers to lose their equity as well. It is a snowball effect resulting in a decline in all businesses in our rural towns and cities.

I appreciate the subcommittee asking me to testify here today. I would like to leave you with one thought, and that is farm profit.

If there was profit in agriculture the last few years, there would be no need for any of us to be here today. The bottom line is profit. Rural America would be booming if farmers and ranchers had a profit.

Thank you.

Mr. **JONES** of Tennessee. Thank you very much, Mr. Wienk, for your statement. We appreciate your attendance and know it was with some difficulty for you to be here, without a doubt—for all of you members, as far as that goes.

At this point I think that the subcommittee might want to ask the panel some questions, and I yield to Mr. Daschle for any questions he might have.

Mr. **DASCHLE**. Arnold, I appreciate your comments about the experiences you've had at a PCA. I'd like to just elaborate on them a little bit in what time I have.

How much of a variance is there in the interest rates now, in the loans to PCA borrowers? Do you know?

Mr. **WIENK**. It's around 1½ percent.

Mr. **DASCHLE**. One and a half percent. It's my understanding that the riskier borrower gets the higher rate of interest, is that what you said?

Mr. **WIENK**. That's right.

Mr. **DASCHLE**. When did this practice begin?

Mr. **WIENK**. Within the last year.

Mr. **DASCHLE**. Is it your understanding that this practice is not something local, that it's pretty widespread and was dictated to the local PCA's from either the Omaha district or from Washington? Is that what you were told?

Mr. **WIENK**. I believe so, because I've talked to several people from different areas.

Mr. DASCHLE. You also mentioned that your stock has been frozen. As I recall, this took place in July, did it not?

Mr. WIENK. Yes, it was June or July.

Mr. DASCHLE. Having frozen the stock, what ramifications does that have for a borrower like you?

Mr. WIENK. It raises our interest rate because even if we pay some off of it, we're still paying on all the B stock that we originally had. It's frozen as of the day that they decided to do that. So even if you paid them off, you're still going to pay on that B stock.

Mr. DASCHLE. In other words, since you can't take it out, since it's frozen there, regardless of what else you may do with the loan itself you have to continue to pay on the stock for the indefinite future?

Mr. WIENK. Yes, unless you just outright buy it.

Mr. DASCHLE. How much of a payment would that be?

Mr. WIENK. Well, it would be 10 percent of whatever your loan would be.

Mr. DASCHLE. So you're paying a 10-percent rate on the stock itself?

Mr. WIENK. No——

Mr. DASCHLE. Oh, I see—10 percent——

Mr. WIENK. You're paying the regular rate of interest, but it's 10 percent more than whatever your loan is. If you got $100,000, you're paying on $10,000.

Mr. DASCHLE. If there were one or two things in all of the different things that one could consider as options, as possibilities to deal with the problem we have in the Farm Credit System today, from your hands-on experience, from your viewpoint, what would they be? What would be the most successful thing that we could do?

Mr. WIENK. Well, we'd have to get our interest rates down, and we'd have to get profit in agriculture.

Mr. DASCHLE. OK. Well, within the Farm Credit System alone, if there was some way to reduce the rate of interest, that would be the single best thing?

Mr. WIENK. Yes, this would help a lot.

Mr. DASCHLE. Would there be much call, would there be much need in your opinion for restructuring the outstanding indebtedness at a lower rate of interest, besides providing new loans at a lower rate?

Mr. WIENK. Would you repeat that?

Mr. DASCHLE. Would there be a need for, in your opinion, a restructuring of the outstanding indebtedness that exists today within your loan portfolio at a lower rate of interest?

Mr. WIENK. Yes, I think this would be quite an answer to a lot of problems.

Mr. DASCHLE. So it's not only providing loan availability at a loan rate, but the current loans that you have in your portfolio ought to be lowered too, that's what you're saying?

Mr. WIENK. Yes, because—see, we're not very competitive at all now at banks.

Mr. DASCHLE. Thank you again, and I want to thank the entire panel for some very informative testimony.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Daschle.

Mr. Evans, I yield the time to you.

Mr. Evans of Iowa. Thank you, Mr. Chairman.

I want to address my remarks and questions to Mr. Cobb from Texas. I want to say how much I appreciate your testimony and the very detailed documentation that you have there——

Mr. Cobb. Thank you, sir.

Mr. Evans of Iowa [continuing]. And I assure you I'm going to look at it thoroughly before this activity by the committee is over.

But I did want to pursue something. I was very much interested in your concern for reserves for losses and the history of this, and the levies being imposed upon prudently run organizations such as yours to get access to those losses. And I understand your concerns.

I have long been concerned by the flaw in the act, or I view it as a flaw in the act, that from the very inception of the system it failed to provide for some central reserve available to the Governor that he could move around the country to points of crisis rather than having to come in moments of crisis to organizations such as yours and collect your hard-earned reserves in order to address someone else's problems. I assume that you agree with me that this is part of the problem, and might be part of the solution if we were to provide in legislation for some kind of central reserve available to the Governor. Would you like to comment on that at all?

Mr. Cobb. Sir, I think that would be an excellent idea, and I think it would be totally consistent with some of the theories that I've advanced in this testimony in that that would be a preplanned and predetermined, prearranged situation. It would be in anticipation of problems that would arise down the road, and I think would very effectively solve some of the problems that we're facing today, yes.

Mr. Evans of Iowa. If I may pursue a somewhat different line of inquiry with you, you people obviously accumulated substantial reserves and have some others. But I believe the act and the regulations are rather silent on what you can do with those reserves and how you invest them. And I'm under the impression that at least in some organizations, the practice has been not to keep those reserves in something that is relatively liquid, so that it can be brought to bear on the problem, but in many instances where—perhaps in some of those instances it should not have been done, those reserves are not liquid but have been loaned out to farmers in the form of additional loans. Under some circumstances that might be a rather prudent practice, and under some others it might not be. I am under the impression that throughout the system a lot of reserves for losses and other segments of retained earnings within associations have, perhaps to an imprudent extent, have been used to finance additional loans to farmers. Those reserve capital assets can be in considerable trouble in times of crisis.

I think neither the committee nor I have a very good understanding of that particular problem and how the system operates. Would you care to comment on that for just a moment?

Mr. Cobb. Yes, sir, I'd be happy to.

Back in the early history of our organization we had a part of our capital invested in Government bonds which, at that time, was a prudent move because we in many instances could obtain a better yield on those Government bonds than we were having to pay in the form of a discount rate to our credit bank. So obviously that was a wise decision. But in recent years we have felt that any surplus funds that we had would best be invested in the loans that we were carrying because we were going to have that loan portfolio anyway, and what we might have available was not going to have very much bearing on the quality of loan that we were going to extend.

So we were going to have, say, *x* number of dollars of loans invested, so we felt—and have felt through the recent past—that that surplus money would be best not invested in anything else except to increase what we call "our own funds," which is simply the difference between what we have in loans outstanding and what we're borrowing from the intermediate credit bank; and the greater ratio of that so-called own funds that we might have serves to reduce the interest that we're obliged to charge our borrowers because we can operate on a smaller spread by simply refraining from borrowing that extra money.

Mr. EVANS of Iowa. I see that we've already run out of time, and I thank you very much for your comments.

Mr. JONES of Tennessee. Thank you, Mr. Evans, for your comments.

And now, the Chair yields to Mr. Stenholm.

Mr. STENHOLM. Thank you, Mr. Chairman.

Pursuing that line of questioning a little further, Mr. Wienk, what is your current interest rate at your PCA in the differential of 1½ points?

Mr. WIENK. Being it's variable, I think it's running from just under 13 to just over 14.

Mr. STENHOLM. Oh, 13 to 14.

Mr. Cobb, what are you charging now? Or I should say, what am I paying now?

Mr. COBB. Mr. Stenholm, as of today you're paying 10.45 for your money.

Mr. STENHOLM. What's the spread you're operating on?

Mr. COBB. It's 75 points above the bank discount rate.

Mr. STENHOLM. Another question. The Farm Credit Administration recently said that it needs additional powers. Would you give your comments on that request of Farm Credit Administration?

Mr. COBB. Charley, frankly and candidly we've never observed that the Farm Credit Administration was lacking in any power. It seems to me like they've had all the power that they've needed to do almost anything they chose to do through the years. So we do question the extension of additional powers, except maybe in some very isolated cases where it might smooth some operations or something. But as far as a general overhaul and general extension of additional powers, we would question the necessity of it. I think our district banks would concur in that position, also.

I think in that regard, just to give an example of what I'm talking about insofar as the additional powers are concerned, if a PCA president or district bank had made as many errors in judgment as we think the Farm Credit Administration has made in recent years, that PCA president or that bank president would not still be on the scene. So they do have quite a lot of power.

I know this, too, in February 11 or 12 of this year the concept of the "central entity" was advanced, and that was a part of this so-called package of additional powers, or seeking additional powers, to the Farm Credit Administration. This particular package, the central entity concept, was transmitted to us on the PCA level on March 11, 1985, and our board took a look at it and they—incidentally, the central organization has been remanned now, but—the concept was to create that organization and be granted only the powers that FCA would give to it. Yet it would have complete responsibility for a variety of things. It was planned from the beginning that it be off and running within a matter of a couple of months, and we felt like if it was the best thing that was ever devised since motherhood and apple pie, it would stand the test of some examination without being implemented all of a sudden, without everybody having a chance to have input on it and look at it.

In late March, the plan was announced. Our board, among other things, made this observation about that concept:

> The extreme urgency in getting it implemented poses major concerns to this board. The timetable anticipated adoption and implementation within a very brief period; yet, its basic tenets are to return control of the System to its owners, solicit input from farm credit entities, permit a variety of views within the System, and provide democratic representation. None of these appear to be present in the proposed formative steps, with no time or opportunity granted to those with the most vital interest in the matter to present views on the concepts advanced. In the absence of evidence to the contrary, it appears that the Farm Credit Administration, one, has come to recognize the precarious position of the entire Farm Credit System as impacted by the national agricultural economy; two, desires to create the central entity as rapidly as possible so that the responsibility and accountability for the economic ills or failure to assist them or any of its constituent elements can be relegated to the new entity; and three, perceives that this divestiture will remove the onus of current and projected problems of the System itself. Yet, FCA will retain the same authority it has had in the past without attendant responsibility through strict control of the central entity.

And incidentally, there is a very good, long-time friend of mine, Alton Cook, who is interim CEO of this new organization. Now, I have the utmost confidence in his ability and his integrity; and if it can be made to work effectively, he can do it. But I suspect the authority that he will be given by FCA will be very limited and the organization he heads will be asked to bear the brunt of many of the past errors of judgment and current ills of the system.

Mr. STENHOLM. Thank you very much.

Mr. JONES of Tennessee. Thank you very much, Charley, and thank you, Mr. Cobb, for those remarks.

Mr. Franklin.

Mr. FRANKLIN. Thank you, Mr. Chairman. If I do have some questions, I'll get back to them. I yield back the balance of my time since we do have a vote.

Mr. JONES of Tennessee. Thank you, sir.

Very hurriedly, I want to ask of Dyersburg what rate of interest am I paying, Bob?

Mr. HENDRIX. You're paying 12.25.

Mr. JONES of Tennessee. I've got you beat, Charley.

Mr. STENHOLM. I'm not competing with you on that. [Laughter.]

Mr. JONES of Tennessee. Sam, what's the rate over in your country?

Mr. **Lester**. I think the land bank now—I mean the PCA—is 12.75, and of course the land bank is 13.25. Of course, to get your true APR you have to add stock on that. Land bank would be 14.2 and you go from there.

Mr. **Jones** of Tennessee. OK.

We have a vote, and I want to thank everybody——

Mr. **Stenholm**. Mr. Chairman, if I might, I have five additional questions that I want to submit to Mr. Cobb in writing in order to have that interjected in the record.

[The material follows:]

Responses to questions submitted by Hon. Charles Stenholm
to Mr. R. C. Cobb:

Question: FCA has said recently it needs additional powers. What is your thinking on this?

Answer: From local Association standpoint, we have never observed that FCA was lacking in any authority. I think District Banks would concur in this, also. I believe this observation could be made on the subject: If a PCA President or a District Bank President had made as many errors in judgment as FCA has made in recent years, that Association or Bank President would no longer be on the scene.

Additional authority is being sought through the "Central Entity" concept advanced in a document unveiled on February 11 and 12, 1985. It was transmitted to PCAs on March 11, 1985. The new central organization, which has since been renamed Farm Credit Corporation of America, would only have powers granted to it by FCA. Yet, it would have complete responsibility for a variety of things. It was planned from the beginning that it be off and running within a matter of a couple of months.

In late March, soon after the plan was announced, our Board among other things made this statement about Central Entity (FCCA):

"The extreme urgency in getting it implemented poses major concerns to this Board. The timetable anticipated adoption and implementation within a very brief period. Yet, its basic tenets are to return control of the System to its owners, solicit input from Farm Credit entities, permit a variety of views within the System and provide democratic representation. None of these appear to be present in the proposed formative steps, with no time or opportunity granted to those with the most vital interest in the matter to present views on the concepts advanced.

"In the absence of evidence to the contrary, it appears that the Farm Credit Administration:

a. Has come to recognize the precarious position of the entire Farm Credit System as impacted by the national agricultural economy.

b. Desires to create the Central Entity as rapidly as possible so that responsibility and accountability for the economic ills or failure of the System, or any of its constituent elements, can be relegated to the new entity.

c. Perceives that this divestiture will remove the onus of current and projected problems of the System itself, yet FCA will retain the same authority it has had in the past, without attendant responsibility, through its strict control of the Central Entity.

"The hasty effort to get it implemented causes an extremely negative reaction when those most affected have had no opportunity to discuss and become familiar with it and learn more of its implications."

A very good and long-time friend of mine, Alton Cook, is interim CEO of the new central organization. I have utmost confidence in his ability and integrity. If it can be made to work effectively, he can do it, but I expect the authority he will be given by FCA will be very limited and the organization he heads will be forced to bear the brunt of many of the past errors of judgment and current ills of the System.

Question: Exhibit "B" to your testimony showed your association had 270 stockholders 35 years of age and under in February 1977. Do you have any information of what has happened to these borrowers since then?

Answer: Yes, we recently checked our records to determine exactly what has happened to these 270 stockholders since February 1977. Approximately 50% are no longer operating or are not borrowing from us. Almost all of those still operating and not borrowing from us are being financed by FmHA. We have no way of knowing exactly how many are still operating with FmHA credit but would estimate the number to be fairly small.

Another interesting bit of information about the young operators financed in 1977, whom we still finance, is that a random sampling indicates the husband and/or wife, work at another job off the farm or ranch. With this help they have been able to stabilize their financial position, and in most cases reflect some financial gain since 1977. Outside employment is not an appropriate solution for some older operators due to unavailability of jobs, lack of skills or stamina to perform outside employment.

Question: Why do you favor single management of district banks while there is quite a bit of opposition in your district, especially from FLBA's?

Answer: In answer to this question, I would have to draw on our own history and experience. In March, 1965 the Stamford PCA merged with the Memphis (TX) PCA. At that time the merged Association had nine offices. At the same time, the FLBAs serving the same territory, which actually included parts of about seven FLBAs, had a total of eight offices in these counties. Currently, we have five offices and the FLBAs have four, two of which are in the same towns in which we have offices. If somehow we could have gotten our act together then, with single management on the local level, at least some of the offices that were closed could have remained open. It probably would not have produced much greater economy, but the convenience and needs of farm and ranch operators would have been much better served.

The point is sometimes made that PCA and FLBA personnel are specialists in their respective type of lending and probably could not do as good a job handling both short and long-term credit. I do not believe this for one minute. Commercial banks handle dozens of different type loans, and it does not seem to inhibit their operations. It could be argued that you need a specialist on nouns, a specialist on verbs and maybe one on dangling participles, but agricultural economic forces will not permit that much specialization.

Question: Under present agricultural economic conditions should there be some special dispensation granted to allow the major part of earnings to be set aside in provisions for loss accounts rather than be treated as taxable income?

Answer: Yes, very definitely. In today's agricultural economy an acceptable loan performing very satisfactorily can become a problem or possibly a loss loan within a year's time. For this reason, if an association has

Provision for Losses equal to the 3 1/2% of loan assets, losses that could be identified in any given year could totally deplete that reserve account. If some dispensation were granted to allow the major part of current earnings to be transferred to Provision for Losses, each PCA would be in a much better position to weather the agricultural economic crisis currently upon us. Under the Loss Sharing Agreement in place, and other factors, concerned in the review of PCAs' operations, "after tax" dollars going into the surplus account do not provide as much flexibility or cushion against loss in coping with this problem as "before tax" dollars placed in the Provision for Loss account.

Question: It seems your association has been rather persistent in board statements and positions on the "provision for loss" issue. Have you tried other methods of making your concerns known?

Answer: Most certainly we have. In November 1980 it was my privilege to work a week in the FCA and Department of Agriculture on a publication entitled AGRICULTURAL OUTLOOK 1981. These concerns were made known to everyone who would listen, almost to the extent I felt like I was making a nuisance of myself.

When inattention continued to be given to the problem, we decided to use another tactic. In January 1984 we underwent an examination by a team of FCA examiners. When the examiner in charge arrived, we advised him that we welcomed an examination anytime anyone thought it was necessary, but we wanted the opportunity to present some information that the Farm Credit Administration did not seem to be conscious of, or at least their actions did not indicate it. On Friday afternoon of the first week of the examination, we spent about four hours discussing the problems as we perceived them to be and the concerns we had about the System. The examiner stated repeatedly that he was not in a policy making position and that he could only transmit our information to the appropriate people. We assured him that we understood this thoroughly, but that he was the only FCA representative available to us to discuss these matters and that we respectfully requested that he see that the appropriate policy makers were advised of the circumstances. As far as we could determine, no action was ever taken on the apprehension we expressed.

In the spring of 1984 during the FICB Annual Stockholders Meeting held that year in San Antonio, we related these concerns to an aide of FCA Governor Wilkinson, who did not have time to hear them himself.

Question: What was the reaction in your association to the press release carried in the "Wall Street Journal" on September 4, 1985, that dealt with the severe financial condition of the farm credit system?

Answer: We are extremely distressed over the fact that in July and even since then, FCA continued to reaffirm that everything was fine, and we knew at the time it was not. Then in the first week of September, FCA gave an entirely different assessment. The contents of the front page story in THE WALL STREET JOURNAL on September 4, 1985 caught the Texas District Banks completely by surprise, according to a memo received from the Farm Credit Banks of Texas.

We believe something as important and far-reaching as the information made available to THE WALL STREET JOURNAL should have been discussed with the Presidents of the Farm Credit Banks of the nation before it was released to the press. It must have been pretty embarrassing to District Banks over the nation to read about it initially in THE WALL STREET JOURNAL and be obliged to answer questions about it the entire week.

The resulting impact on FCS bond interest costs will be an additional expense to farmers and ranchers running in to many millions of dollars. Anything as far reaching as this, obviously should have been closely coordinated with District Banks before giving it the publicity it received. We are hopeful the damage done will be abated to some extent in the future. However, it is somewhat like the effect of an attorney's methods in the courtroom in which he knows a statement may be objected to and the objection sustained, but damage in the eyes of the jury will remain. Even after hard facts are made known, we are fearful the effect on the bond market will remain.

Mr. **Jones** of Tennessee. Without objection. Sure.

And anyone else who has them may do likewise, without objection. And I'd like to have that same privilege.

Yes.

Mr. **Hendrix**. Mr. Chairman, I'd like to make one more statement. We pay 10 basis points for the sale of our bonds to agents who handle these bonds, through a fiscal agent. I would suggest that the possibility of charging one-hundredth of a basis point on those bonds, which would not be a big cost to any one member, but in the entire Farm Credit System—that would involve the Federal Land Bank, Production Credit, and co-ops—this would generate $74 million a year to go into reserve to cover some of these losses. I suggested this before and I'm told it can't be done without legislation, but it seemed to me that this would be a less painful way of covering some of our losses than it would to have to go through loss sharing or some other means. At the same time, when the economy turns around and the Farm Credit System is back on its feet, continue this reserve to a point that it would be self-perpetuating. Then when the need would occur at a later date, you would have this reserve to draw on. This is a suggestion that I didn't have in my remarks, but I think it has possibilities of being looked into sometime in the future.

Mr. **Jones** of Tennessee. Bob, if you don't mind, I'm going to ask you to put that in writing. We have a vote on the floor, so we will adjourn until 10 a.m. tomorrow morning.

[Whereupon, at 3:44 p.m., the subcommittee recessed, to reconvene at 10 a.m. Thursday, September 12, 1985.]

[Material submitted for inclusion in the record follows:]

Congressman Larry J. Hopkins

Conservation and Credit Subcommittee
House Agriculture Committee
September 11, 1985

MR. CHAIRMAN, MEMBERS OF THE SUBCOMMITTEE, I WOULD LIKE TO THANK YOU TODAY FOR CALLING THIS HEARING TO DISCUSS CURRENT PROBLEMS IN THE FARM CREDIT SYSTEM. THIS HEARING IS ESPECIALLY TIMELY IN LIGHT OF THE HOUSE AGRICULTURE COMMITTEE'S ACTION LAST NIGHT TO REPORT A FARM BILL TO THE FULL HOUSE FOR CONSIDERATION.

WE ARE ALL DISCOVERING THAT PROBLEMS WITH THE FARM CREDIT SYSTEM ARE BECOMING AS IMPORTANT TO THE FARMERS WE REPRESENT AS THE MAKE UP OF THE FARM BILL WE JUST PASSED. FRANKLY, I THINK THIS ISSUE TOOK MOST OF US BY SURPRISE.

THE FARM CREDIT SYSTEM HAS PERFORMED ITS DUTIES WITH RELATIVELY LITTLE CONGRESSIONAL INVOLVEMENT SINCE ITS BEGINNING IN 1916. AS A MEMBER OF THE HOUSE AGRICULTURE COMMITTEE I AM USED TO DEALING WITH ISSUES INVOLVING THE FARMERS HOME ADMINISTRATION. HOWEVER, WHEN PROBLEMS WITH THE FARM CREDIT SYSTEM EMERGED, I HAD TO GO BACK AND DO A LOT OF HOMEWORK

I HAVE HAD MEETINGS AND CORRESPONDED WITH INTERESTED SHAREHOLDERS AND LOCAL DIRECTORS IN MY DISTRICT OVER THE AUGUST RECESS. TWO MAIN CONCERNS HAVE BEEN EXPRESSED TO ME. FIRST, BORROWERS ARE CONCERNED ABOUT THE RECENT INCREASE IN INTERST RATES. ON JUNE 1 THEY WENT FROM 12.75% TO 13.25%. THIS HAS BEEN EXPLAINED AS A SYMPTOM OF THE WEAK FINANCIAL CONDITION OF THE SYSTEM. HOWEVER, IT IS ALSO INCREASING THE PROBLEM BY DRIVING THE "GOOD RISK" BORROWERS OUT OF THE SYSTEM AND INTO THE ARMS OF PRIVATE LENDERS.

THE SECOND CONCERN EXPRESSED IN MY DISTRICT IS OVER PROPOSALS TO MERGE THE ASSOCIATION INTO ONE DISTRICT. MANY LOCAL ASSOCIATION DIRECTORS IN MY DISTRICT UNDERSTAND THE SERIOUS FINANCIAL CONDITION OF THE SYSTEM. HOWEVER, THEY DO NOT WANT THIS CONCERN TO BE USED AS A SMOKESCREEN TO MAKE FURTHER CHANGES THAT ARE UNWARRANTED AND UNDERMINE THE CONGRESSIONAL INTENT OF THE FARM CREDIT ACT THAT THE SYSTEM BE FARMER OWNED AND OPERATED.

CONCERN HAS BEEN EXPRESSED THAT DIRECTORS OF LOCAL ASSOCIATIONS WILL NO LONGER BE NEEDED. MEMBER LOANS, WHILE SERVICED IN THE SAME AREA, WILL NOT HAVE THE VALUE OF A LOCAL BOARD HEARING BEFORE FORECLOSURE OR CERTAIN OTHER SERVICING IS APPLIED TO THE LOAN. DECISIONS WILL BE MADE BY A SMALL NUMBER OF PEOPLE AT A CENTRALIZED LOCATION. THE EMPLOYEES OF THE SYSTEM WOULD BE DIRECTLY RESPONSIBLE TO ONE PERSON AND THE BANK PRESIDENT WOULD AMASS TREMENDOUS POWER. THESE AND OTHER REASONS COULD ERODE CONFIDENCE IN A SYSTEM NO LONGER CONTROLLED AT THE GRASSROOTS LEVEL.

THIS IS NOT TO SAY THAT LOCAL ASSOCIATIONS ARE NOT WILLING TO RESPOND TO THE PROBLEMS OF THE SYSTEM. INDEED, I THINK MOST WOULD SUPPORT THE ORIGINAL PROPOSAL TO REDUCE THE NUMBER OF ASSOCIATIONS IN THE 4TH DISTRICT DOWN TO 28. AND THEY HAVE ALSO ASKED THAT LOSS SHARING AGREEMENTS BE USED INSTEAD OF FORCING ALL OF THEIR ASSETS TO BE SENT TO ONE SUPER ASSOCIATION WITH NO POSSIBILITY OF PAYBACK. THEY ARE CONCERNED THAT TIME AND ENERGY IS BEING SPENT ON MERGER PROPOSALS WHICH MAY HAVE LITTLE OR NO EFFECT ON THE FINANCIAL SOUNDNESS OF THE SYSTEM WHEN EFFORTS

WOULD BE BETTER SPENT STRENGTHENING THE SYSTEM.

THE FORCED MERGER ISSUE CONCERNS ME BECAUSE OF ITS POSSIBLE VIOLATION OF THE CONGRESSIONAL INTENT OF THE FARM CREDIT ACT. THE ACT CLEARLY PROVIDES THAT ASSOCIATIONS CAN MERGE. HOWEVER, IF COERCIVE MEASURES ARE USED TO INTIMIDATE ASSOCIATIONS INTO AGREEING TO MERGE, THAT, TO ME, IS NO LONGER IN ACCORDANCE WITH CURRENT LAW. OF COURSE THE CONGRESS MAY CHANGE THIS LAW AS IT SEES FIT. BUT CHANGES IN THE LAW MUST BE MADE BY THE CONGRESS, NOT BY THE DISTRICT BOARDS OF THE FARM CREDIT SYSTEM.

AS I SAID EARLIER, I HAVE BEEN SUBJECTED TO A CRASH COURSE ON THE FARM CREDIT SYSTEM SPURRED BY THE CONCERNS OF MY CONSTITUENTS. I DO NOT CLAIM TO BE AN AUTHORITY OR HAVE ALL THE MAGIC ANSWERS. I AM HOPING THAT THE INFORMATION PROVIDED HERE DURING THE NEXT TWO DAYS WILL HELP ME DECIDE WHAT ACTION SHOULD BE TAKEN. AT THIS POINT I SIMPLY WANT THE SUBCOMMITTEE TO BE AWARE OF THE CONCERNS I HAVE AND THE SOLUTIONS I AM LOOKING FOR.

THANK YOU.

STATEMENT BY

CONGRESSMAN ARLAN STANGELAND
OF MINNESOTA

MR. CHAIRMAN. FIRST OF ALL, I WANT TO EXPRESS MY PERSONAL APPRECIATION TO YOU FOR SCHEDULING THIS SERIES OF HEARINGS AND FOR YOUR SENSITIVITY TO THE SEVERITY OF TODAY'S AGRICULTURAL CREDIT CRISIS.

YOUR LEADERSHIP IN THIS MOST CRUCIAL AREA IS WELL KNOWN AND I AM HOPEFUL THAT THESE HEARINGS WILL SERVE AS A CATALYST FOR THOUGHTFUL CONGRESSIONAL INITIATIVES TO ADEQUATELY ADDRESS THE UNIQUELY DIFFICULT CREDIT PROBLEMS NOW FACING AMERICAN AGRICULTURE.

JUST LOOK AT TODAY'S HEADLINES -- "MORE FARMERS OVEREXTENDED", "FARMLAND VALUES CONTINUE TO FALL", "AGRICULTURAL PROBLEM BANKS REACH RECORD NUMBERS", "FARM CREDIT SYSTEM FALTERING", "MULTI-BILLION DOLLAR CREDIT BAILOUT NEEDED". WHAT IS THE ANSWER DURING THIS TIME OF $200 BILLION DEFICITS? WHEN FEDERAL RESOURCES ARE ALREADY STRETCHED TO THE BREAKING POINT, CAN WE AFFORD THE MAJOR NEW INITIATIVES THAT SEEM NECESSARY TO PATCH UP AN EXTREMELY AILING AGRICULTURAL CREDIT SYSTEM?

I DON'T THINK THERE'S ANYONE ON THIS COMMITTEE WHO DOESN'T BELIEVE THAT THE ONLY REAL LONG-TERM SOLUTION MUST INVOLVE FARMERS GETTING A DECENT PRICE FOR THEIR CROPS. BUT IN THE ABSENCE OF A MODERN DAY MIRACLE, THAT IS NOT GOING TO HAPPEN SOON.

IN THE MEANTIME, WE MUST SEARCH FOR CREATIVE WAYS IN WHICH TO MANAGE A SNOWBALLING SITUATION THAT FUNDAMENTALLY THREATENS THE VERY FOUNDATION OF AMERICAN AGRICULTURE AND OUR ENTIRE ECONOMY. FARMING IS AN EXTREMELY CREDIT-INTENSIVE BUSINESS. WITHOUT ACCESS TO A RELIABLE AND REASONABLY PRICED CREDIT SOURCE, AMERICAN AGRICULTURE CANNOT SURVIVE. AND IF THE $74 BILLION FARM CREDIT SYSTEM AND THE COUNTLESS RURAL BANKS THAT HEAVILY DEPEND UPON AGRICULTURAL LOANS FOR THE BULK OF THEIR CREDIT PORTFOLIO ARE NOT ADEQUATELY ASSISTED, I TRULY FEAR THAT THE EVER-WIDENING GULF OF MISERY NOW BEING EXPERIENCED IN AGRICULTURE COULD SWALLOW THE ENTIRE COUNTRY.

I CANNOT SAY WHAT THE TOTAL ANSWER IS AS FAR AS OUR BELEAGUERED FARM CREDIT SYSTEM IS CONCERNED. MR. CHAIRMAN, I KNOW THAT YOU AND THE OTHER SUBCOMMITTEE MEMBERS WILL BE CAREFULLY CONSIDERING THE VARIOUS POLICY OPTIONS THAT WILL BE NECESSARY TO ASSURE THE SYSTEM'S SOLVENCY AND FUTURE VIABILITY AS A MAJOR SOURCE OF PRODUCER CREDIT IN THIS COUNTRY.

BUT I DO WANT TO TAKE THE TIME TO BRIEFLY EXPLAIN AND URGE MY COLLEAGUES TO LOOK AT A BILL THAT I HAVE INTRODUCED, H.R. 2064, WHICH I BELIEVE OFFERS SOME INTERIM CREDIT RELIEF AND HOPE FOR HARD-PRESSED FARMER BORROWERS.

H.R. 2064, THE MODIFIED DEBT RECOVERY ACT OF 1985, WAS ORIGINALLY PROPOSED BY A FARM ORGANIZATION IN MY DISTRICT, COMMUNICATING FOR AGRICULTURE. IT HAS SINCE BEEN ENDORSED BY THE MINNESOTA FARM BUREAU, MINNESOTA FARMERS UNION, AND THE MINNESOTA CHAPTERS OF THE NATIONAL FARMERS ORGANIZATION AND AMERICAN AGRICULTURE MOVEMENT. IN ADDITION, THE MINNESOTA BANKERS ASSOCIATION AND INDEPENDENT BANKERS OF MINNESOTA, ALONG WITH NUMEROUS COMMODITY GROUPS, HAVE ALSO EXPRESSED THEIR SUPPORT FOR THE CA DEBT RESTRUCTURING PLAN.

WHILE I WON'T GO INTO EVERY DETAIL OF THE BILL, LET ME EXPLAIN FIVE MAJOR FEATURES OF THE COMMUNICATING FOR AGRICULTURE MODIFIED DEBT RECOVERY PROGRAM, AS CONTAINED IN H.R. 2064.

1) COMMERICIAL LENDERS, UNDER THE FARMERS HOME ADMINISTRATION'S APPROVED LENDERS PROGRAM, WOULD BE AUTHORIZED TO PROCESS FMHA REGULAR AND LIMITED RESOURCE DIRECT LOANS (IN ADDITION TO THEIR PRESENT AUTHORITY TO PROCESS FMHA GUARANTEED LOANS). FMHA WOULD RETAIN FINAL AUTHORITY TO ACCEPT OR REJECT THE LOAN APPLICATION.

2) AN INTEREST RATE CEILING ON FMHA GUARANTEED LOANS, UNDER THE APPROVED LENDERS PROGRAM, WOULD BE SET AT 2 1/2 PERCENT ABOVE THE FEDERAL RESERVE DISCOUNT RATE.

3) AN APPROVED COMMERCIAL LENDER WOULD BE AUTHORIZED TO FIND THE PROPER BLEND OF FMHA LOAN GUARANTEES AND REGULAR OR LIMITED RESOURCE DIRECT LOANS SO THAT THE FARMER'S OPERATION WOULD SHOW A POSITIVE CASH-FLOW. FMHA WOULD ALWAYS MAINTAIN THE AUTHORITY TO REJECT ANY PROPOSED CREDIT PACKAGE THAT DID NOT APPEAR PRUDENT.

4) ANYTIME THE APPROVED COMMERCIAL LENDER INCLUDED FMHA DIRECT LOAN MONIES IN THE FARMER'S CREDIT RELIEF PACKAGE, THE LEVEL OF THE FEDERAL GUARANTEE ON THE REMAINING LOAN GUARANTEE PORTION OF THE CREDIT PACKAGE WOULD BE SET AT 60 PERCENT (INSTEAD OF THE NORMAL 90 PERCENT FMHA LOAN GUARANTEE LEVEL).

5) ON ANY SUCH FMHA LOAN GUARANTEE AND DIRECT LOAN PACKAGE PROCESSED BY AN APPROVED COMMERCIAL LENDER, THE SECURITY ON THE ENTIRE CREDIT PACKAGE WOULD BE ALLOCATED BETWEEN THE PRIVATE LENDER AND FMHA ON A PRO-RATED PERCENTAGE BASIS ACCORDING TO THE DEGREE OF EACH LENDER'S EXPOSURE. PRESENTLY THE SECURITY IS ITEMIZED FOR EACH FMHA LOAN.

MR. CHAIRMAN, H.R. 2064 MAY NOT BE THE THE TOTAL ANSWER, BUT IT'S A START. H.R. 2064 WOULD LOWER INTEREST RATES, EASE REPAYMENT TERMS, IMPROVE THE TURNAROUND TIME ON LOAN PAPERWORK, EQUITABLY

SHARE THE RISK BETWEEN PRIVATE LENDERS AND THE FEDERAL GOVERNMENT, AND OFFER SOME HOPE TO FINANCIALLY-SQUEEZED FARMERS.

DURING THIS TIME OF SEVERELY LIMITED FEDERAL RESOURCES, WE CAN'T DO EVERYTHING. BUT WE CANNOT AFFORD TO DO NOTHING. THE CA PLAN OFFERS WHAT I BELIEVE IS A BALANCED BLEND OF RISK-SHARING BY THE PRIVATE LENDER, THE FARMER, AND THE FEDERAL GOVERNMENT.

THE AUTHOR OF THE CA PLAN, MR. N. ROLLIE LAKE, IS A RETIRED AGRICULTURAL BANKER, A CONSTITUENT, A LONG-TIME FRIEND, AND IS PRESENTLY SERVING AS PRESIDENT OF COMMUNICATING FOR AGRICULTURE. I HOPE YOU WILL LISTEN CLOSELY TO HIS TESTIMONY LATER TODAY AND CAREFULLY CONSIDER THE 20 YEARS OF AGRICULTURAL LENDING EXPERIENCE ROLLIE HAS CALLED UPON IN CRAFTING HIS THOUGHTFUL PROPOSAL.

IN ADDITION, LET ME BRIEFLY MENTION A PROPOSAL MADE BY A CONSTITUENT OF MINE WHO SERVES IN THE MINNESOTA STATE LEGISLATURE, STATE REPRESENTATIVE MERYL VALAN.

REPRESENTATIVE VALAN IS ADVOCATING THE CREATION OF STATE AGRICULTURAL BOND PROGRAMS, INCORPORATING BOTH STATE AND FEDERAL TAX INCENTIVES, TO PROVIDE LOW-INTEREST DEBT RESTRUCTURING LOANS FOR FAMILY FARMERS.

ALTHOUGH THE WATCH WORDS IN WASHINGTON -- INSOFAR AS THE FEDERAL TAX CODE IS CONCERNED -- ARE "SIMPLIFICATION" AND "STREAMLINE", I

THINK THERE MAY BE SOME MERIT TO EXPLORING THESE IDEAS AND ANY OTHERS WHICH OFFER SOME HOPE OF STABALIZING ASSET VALUES IN RURAL AMERICA.

MR. CHAIRMAN, THANK YOU AGAIN, FOR YOUR CONCERN AND FOR ALLOWING ME TO TESTIFY HERE TODAY. I AM HOPEFUL THAT YOU WILL BE ABLE TO USE THESE HEARINGS AS A SPRINGBOARD TO LAUNCH MEANINGFUL DEBT RESTRUCTURING AND CREDIT RELIEF FOR THOSE HARDWORKING MEN AND WOMEN WHO WILL OTHERWISE BE FORCED OF THEIR FARMS.

Statement of

Congressman Pat Roberts

Mr. Chairman. First, I want to commend you on holding these hearings today. During the August recess, I spent the entire month in my Congressional district visiting all of my 58 counties. Each year we conduct what we call our "Big First" listening tour. Without a doubt the number one concern was the deteriorating farm credit situation. In that respect, Mr. Chairman, this hearing is right on target. Time after time farmers expressed concern over the possibility of losing their credit home and that we must shore up the foundation of our entire farm lending structure. I would like to offer some observations and suggestions .

Last week we heard the Farm Credit Administration do an about face and say that they will need help from the Federal government within 18 to 24 months. Just two weeks before, the Governor of the Farm Credit Administration had said, in Manhattan, Kansas, that the system could handle the problem without Federal help. This announcement sent shock waves through Congress, the Administration, and more importantly the bond market.

This admission, by the regulatory agency responsible for the entire Farm Credit System, sent what I worry could be permanent signals to the bond markets. Unless we act to address this problem and go through the necessary policy debate to pass a Farm Credit Relief package, I think this problem will persist.

In the short term, because of the recent publicity on the over all health of the system, the current bleak outlook for the farm economy, and the uncertainty this has created, I think we should enact legislation, clearly stating that the Federal Government does stand behind the bonds of the Farm Credit

System. Many of the investors have bought Farm Credit bonds under the understandable but mistaken notion that they are federally guaranteed. The recent publicity on the Farm Credit System is creating additional uncertainty. This uncertainty will lead to higher costs for the system and ultimately for farmers.

Congressman Cooper Evans has introduced, and I have co-sponsored legislation, providing for a Federal guarantee of the Farm Credit Bonds. I think this type of legislation or, at the very least, a sense of Congress resolution, spelling out the intent of Congress, similar to what the Senate passed before the August recess, will help to calm the current uncertainty. This type of action by Congress would send the signals to the bond market that it is safe to purchase Farm Credit Bonds and also reduce some of the recent increase in basis points, i.e., the interest rates paid on the Farm Credit bonds and ultimately, the interest paid by the farmer-borrower of the Farm Credit System.

The long term solution to the farm credit problem is of course price and profit for the producer. In lieu of that, there are several things that should be given consideration in the relief package put together for the Farm Credit system.

First, it is time for the system as a whole, to stop raising interest rates to build reserves. The farmer has paid slightly higher interest rates from the day the farm credit system was created to build reserves. If my calculations are correct, the system has $3.407 billion in liquid reserves. Of that $3.407 billion around $500 million has been used or will be used for the Omaha and the Spokane banks loss sharing agreements. That leaves nearly $3 billion in liquid reserves. Those reserves were built up for a rainy day. It is time for the system to commit those reserves.Not only is it raining, hail is predicted. The action the Federal Farm Credit Board took last week on emergency regulations to implement loss sharing was prudent action, given the currentsituation.

While it is important for the Farm Credit System to commit those reserves, they clearly may not be enough. We are talking about a $75.8 billion system, with potential bad loans of up to $15 billion. The farmer was led down the primrose inflation path by government, by bankers, and by so called farm financial wizards, who told him to take advantage of inflation during those "betting on the come" days of the 1970's. Government and market intervention helped create the mess that the farm economy is in right now. It should share in the cost and burden of solving the problem.

However, let me caution this committee and my colleagues that the farmer, and the Farm Credit System, does not want a "Continental Illinois" style bail out. When the Federal government "bailed out" Continental Illinois, the government took over all of the owners stock and replaced the entire management team with hired guns to put the bank back on its feet. The Farm Credit System should retain the local involvement that is the corner stone of the system.

However, any rescue plan should consider giving the Farm Credit Administration regulatory powers to prevent any repeat occurrences of the situation we have today. In addition, I would encourage this Committee to look at the possibility of establishing something similar to what we have for commercial banks and savings and loans, i.e., an insurance fund with appropriate incentives and parameters (similar in concept to the FDIC insurance fund for deposits).

It is my understanding that the Farm Credit Administration, the Farm Credit System, and the Administration are looking at various options and plans to remove the bad paper from the system, such as an Aggie Mae loan guarantee program. This would involve the system, the government, and perhaps commercial banks pooling $3 to $5 billion. With a Federal government guarantee this could then be leveraged to $30 to $50 billion to purchase and hold non-performing loans that the Farm Credit System and the commercial banks now have in the loan portfolios.

This type of program, would help alleviate the crisis in the Farm financial community and would be of service to the entire nation not just farmers.

Once again, thank you for allowing me to share with you my thoughts and concerns on the farm credit situation. What we face is a crisis of confidence. I call your attention to a headline from the business section of last Monday's Washington Post. The headline read:

> "2 Area Investment Funds Hold Farm Credits - Firms Decide To Delay Further Investments Until Farm Crisis Ends"

With this kind of publicity and attitude in the investing public, we must act to shore up confidence in the Farm Credit System bonds, and I look forward to working with you.

STATEMENT OF

CONGRESSMAN COOPER EVANS

BEFORE THE SUBCOMMITTEE ON CONSERVATION, CREDIT, AND RURAL DEVELOPMENT

OF THE HOUSE COMMITTEE ON AGRICULTURE

SEPTEMBER 11, 1985

Mr. Chairman, I appreciate the opportunity to testify here today as you and your subcommittee begin the task of assessing the nature and extent of the Farm Credit System's financial difficulties.

It is my sincere hope that this hearing will lead to a consensus on how to assist this important agricultural lender and the borrowers it serves.

Certainly the prospects for reaching agreement on how to resolve the system's problems have dramatically improved in light of Governor Donald Wilkinson's announcements earlier this month that the system cannot make it on its own and that Federal help is needed.

For the past several months, those of us who have followed this issue most closely have urged the system to come to Congress for assistance. The system's reluctance to do so has been disastrous for its farmer-borrower stockholders who have been paying a heavy price for this "go-it-alone/system-first" strategy in the form of higher interest rates, frozen stock assets, and restrictive and insensitive credit policies.

This is not to say, Mr. Chairman, that we do not welcome Mr. Wilkinson's candid remarks of recent days. His words have carried a sense of urgency that has not gone unnoticed in Washington and for that reason I for one am confident that a solution, however difficult, is certainly possible.

No other issue has occupied my time and attention more than the problems in the Farm Credit System, and my strategy has been to focus on solutions rather than assessing the blame for this crisis. Certainly there is plenty of blame to go around, including the U.S. Congress which created a system with obvious flaws. Congress failed to see the need for a central cash reserve to be moved around the system where and when it is needed. Congress was remiss in not providing for outside audits of the system, so that Congress and the Farm Credit Administration could respond to the developing financial pressures on the system. Congress erred in allowing the system to loan up to 85 cents on the dollar, which now makes the FLBA's and

PCA's vulnerable to declining land values.

The FCS too is to blame for its financial troubles. In the go go years of the late 1970's, the system set out to monopolize agricultural lending in this country, prompting aggressive and in many cases imprudent management practices. In more recent months, the FCS can be blamed for not coming to Congress for help, something it has refused to do until this month.

And then there's the Administration, which we all know has been slow to respond to a range of problems in agriculture in the past couple of years. The Administration's message is this: "Don't ask us for help until you do all the things you can within your own system to solve your problems." This is the Administration's official position and it has resulted in FCS actions that are not good for farmers.

Experience tells us when the system fends for itself in this crisis farmers come out on the short end of the stick.

The emphasis now must be on finding solutions which provide for the system's survival and for the well-being of stockholder borrowers. Actions taken internally have created a terrible loss of borrower confidence in the system, confidence that may not be restored for at least a generation.

The Administration and the Congress must act now. We are already at least six months too late. But fortunately there are things that can still be done. I have proposed several alternatives for strengthening the system and improving the financial outlook for our farmers.

The first thing that would be very easy to do would be for the Farmers Home Administration to broaden its debt restructuring program to include land mortgages which it has so far declined to do. This was a deliberate administrative decision made in connection with that program, and it would be very easy for the Administration to reverse this decision.

A second proposal is for the system to seek use of the revolving funds which now exist in the Treasury in the amount of some $200 million.

Moving into actions which require new authority to be granted under the law, there will be a strong incentive in Congress to seek inexpensive solutions to an expensive problem. There are some essentially zero-cost solutions to the Federal Government. For example, the capital level required for institutions of the FCS are very high compared to other financial institutions. The Intermediate Credit Banks, for example, by law must have 10 percent capital, while the average bank in this country has about 5.5 percent. I have proposed a solution to buy time by reducing this requirement temporarily.

The interest rates charged by the FCS are too high. If the Federal government would finance the prepayment of the high interest bonds in the portfolio, the FCS could make money available to borrowers at much lower rates. I have introduced a proposal which would accomplish this.

One thing that must be done is to get the FLB back in the fixed rate long term mortgage business. And the way to do that is to authorize a special issue of FCS bonds. They would have to be at least 20 years in duration, and this could be used for only fixed rate long term mortgage loans.

Another proposal I have made is for the establishment of a central reserve fund that would be available to the Governor of the Farm Credit Administration for the purpose of assisting troubled institutions. The lack of such a fund during the current crisis has necessitated the cost-sharing agreements which are cumbersome and time-consuming. This fund can be created by an initial appropriation from the Treasury, repaid over several years through modest contributions from the sale of new bonds.

I have also introduced legislation to provide a government guarantee on bonds issued by the Farm Credit System. This is important in retaining investor confidence in the FCS. A loss of confidence in the bond market would drive up the cost of money to the system and, as a result, the interest rates charged to borrowers.

Any proposal for a Federal bailout of the Farm Credit System will also require changes in the way the system is governed in the future in order to prevent a recurrance of the situation we are now facing. One such change, which is supported by the FCS, would be to give the Governor the regulatory powers needed to effectively protect the financial soundness of the system. These would include the power to issue cease and desist orders, to levy civil penalties, and to remove officers and directors of system institutions. Another change would require annual outside audits of each system institution and periodic audits of the entire system by the General Accounting Office. No outside audits are currently required or conducted.

And lastly, I am drafting legislation that would open the system's bonding authority to commercial banks to insure that farmers will continue to have access to farm credit. This has been prompted by the system's decisions to consolidate the banks and associations into one large entity. Although details of the proposal are still being worked out, it would require the system to make at least part of the funds raised through bond sales available to commercial agricultural banks and their farm customers. The system may be pulling out of rural America but we have to keep a source of funds available for farmers who need ready access to credit and who prefer to do their banking on Main Street.

I would be happy to answer any questions you might have, Mr. Chairman, on these proposals or any of the other issues which I have raised here today.

STATEMENT OF
THE HONORABLE BERKLEY BEDELL
BEFORE THE COMMITTEE ON AGRICULTURE
U.S. HOUSE OF REPRESENTATIVES
SEPTEMBER 11, 1985

Mr. Chairman, I greatly appreciate this opportunity to testify today regarding the financal difficulties of the Farm Credit System and their implications for our agricultural economy.

After having talked with farmers, bankers, and small businessmen throughout my District in August, it is quite apparent that we are faced with the real possibility of an economic collapse in rural America. According to the U.S. Department of Agriculture, the Farm Credit Sytem holds nearly one third of all the farm debt currently outstanding in this country with the Federal Land Bank holding 43 percent of all farm real estate loans. Thus, if we are to constructively address the problems of our rural economy, we must ensure that the Farm Credit System is both organizationally and financially sound.

The source of the System's financial difficulties can be found within the same economic problems that continue to plague the individual farmer and Farm Credit System borower. Land values that have plummeted 29 percent in the state of Iowa from April 1984 to April 1985, depressed commodity prices, and an overvalued dollar have had as strong an impact on the Farm Credit System as on its borrowers. Indeed, a report recently released by the Farm Credit Administration (FCA) on the condition and performance of the System for the quarter ending March 31, 1985 clearly show the seriousness of the System's difficulties matches that of its borrowers. In that report the FCA stated that nonperforming loans amounted to a startling 17.5 percent of total outstanding loans for the Federal intermediate credit banks, 14.9 percent for Production Credit Associations, and 10.2 percent for Federal Land Banks.

It is my belief, then, that the most important action that Congress can take toward restoring strength and stability to our agricultural economy and the Farm Credit System is to constructively address the problems of the overvalued dollar, ever increasing budget deficits, depressed land values and low commodity prices. It is my hope that the Farm Bill that was reported out of the House Agriculture Committee yesterday is a step in the right direction.

In the near term, however, because of the important role that the System plays in our agricultural economy and the important interrelationship that it has developed with our entire national economy, some form of additional assistance may be necessary. With between ten and fifteen percent of its current loans classified as non-performing, Donald Wilkinson, Governor of the Farm Credit Administration recently estimated that such government assistance would be needed in 18 to 24 months.

However, in the course of this hearing and the broader Congressional debate on the type of government assistance that should be provided to the Farm Credit System, I believe that there are several important points that must be considered. The first, and perhaps most obvious, is that Congress must carefully balance the needs of the system with its obligation to reduce our budget deficits. In this regard, the System must be required to utilize every resource at its disposal, such as loan-loss reserves, to meet its obligations if the Federal Government is to provide any financial assistance.

The second important consideration concerns the organization and management of the System. When the FCS was originally capitalized by the

Federal Government, it sought to provide farmers with a reliable credit source within a member-owned cooperative that would encourage farm ownership. Now, as various proposals are brought before Congress to protect the financial integrity of the Farm Credit System, we must carefully weigh and measure them in regard to each of these original goals.

Unfortunately, within the System itself, it does not appear that such consideration is always given to these original goals. For instance, while the nation's Farm Credit Banks have moved to provide a package of financial assistance to the Omaha Intermediate Credit Bank, they have done so only with the understanding that the Omaha district reorganize itself to form one Production Credit Association (PCA) from its 37 local and seperate PCAs and one Federal Land Bank Association (FLBA) from the 31 FLBAs.

As member-owned cooperatives, the whole foundation of organization and management in local PCAs and FLBAs has been and should continue to be built upon the input of the farmer-borrower. This foundation of local autonomy has been increasingly undermind though in the past several months as coercive efforts have been made by the System's central authorities to "streamline" the FCS. Indeed, a recent article in the Des Moines Register quoted the Chairman of the Committee that developed the Omaha Financial Assistance Plan as saying, "if you vote reorganization down, it means you don't want assistance." That means, he went on to say, that the Omaha District borrowers would have voted to liquidate their local associations. It seems to me that this type of coercive "take it or leave it" attitude is not the type of constructive and sincere effort that is truly needed right now.

A third point that must be considered in reviewing any proposal to assist the Farm Credit System concerns its effects on the individual borrower. While we must protect the financial integrity of ths System, it is my strong belief that we must also be just as concerned about the financial implications of any assistance plan on the farmer-borrower as we are about the implications for the investor.

While most of the farmers in my district feel that we need a strong Farm Credit System, they are at the same time concerned that the farmer-borrower is being forced to bear full responsibility for mistakes in which local PCAs and FLBAs certainly share the blame. This inequitable distribution of the responsibility for the problems that the System faces is quite apparent in the recent increase in Federal Land Bank interest rates which has served only to drive away many of the Bank's best customers. Thus, it is very clear that we cannot consider any financial assistance plan that would result in higher interest rates for System borrowers.

Similarly, it is my strong feeling that if we are to provide any assistance to the Farm Credit System, we must also make the assistance available to the indpendent banker in our rural areas. We simply cannot initiate a bailout of the lending institutions that are most responsible for the aggressive overlending that burdens our farm economy while we allow the small community banks to struggle on their own.

The seriousness of the current economic situation in agriculture and the need to address the problems of the Farm Credit System, is perhaps best illustrated by a July 1985 report in which Wharton Econometric Forecasting warned that farm loan losses of $20 to $25 billion are possible during 1985 - 1993. If nothing is done to avert them, Wharton estimated that the impacts on the national economy would include: a increase in private short-term interest rates of .75% to 1.25% points; a decrease in business investment of between $24 and $38 billion; a loss of 175,000 to 275,000 jobs; and an increase in the federal debt of $14 to $22 billion by 1993.

Clearly, Mr. Chairman, we must do all we can here in Congress to avoid such an occurence. Again, thank you for this opportunity to testify on this very important matter.

Statement Of

CONGRESSMAN RON MARLENEE

Mr. Chairman: Without reiterating all the rhetoric that has here-to-fore been presented, let me say that the position of jeopardy that the Farm Credit System is in is the result of years of selling products at prices that are below the cost of production and then going to the lender and financing that cheap food policy.

The greatest transfer of wealth the world has ever seen is occurring: the credit crisis. At this time we have two options: (1) either we address this problem in a non-partisan cooperative spirit or, (2) within 6 to 8 months we will see the damnedest crash in real estate values that this nation has ever experienced. It will make the slide in the 30's look like a mere adjustment.

I would call on this committee, the Senate, the Administration, the Federal Reserve, the Farm Credit Administration, the Farm Credit System, and representatives of both the American Bankers Association and the Independent Bankers Association to sit down and without partisanship or pride of authorship, put into place actions which re-establish confidence in the Farm Credit System.

First, I am introducing a Sense of Congress Resolution that a special blue ribbon panel that embraces the bodies of jurisdiction in farm financing be created.

Secondly, Congress, the Farm Credit System and the Administration should establish that the bonds are and will continue to be premium instruments. The result of this would be that these instruments receive interest rate considerations that are premium.

Thirdly, the establishment and support of an entity to handle those loans that cannot be re-structured. This serves two purposes:

(1) It frees up and unburdens the system and other borrowers from having to carry paper that is non-performing.

(2) It keeps real estate from being dumped on the market and further depressing real estate markets.

Some vehicle should be sought to directly lower interest rates to the whole sector of the agriculture community. A 1% rate decrease in interest rates translates into a 10% increase in net farm income.

One way to do this would be through issuance of a one time bond issue that had tax incentives for the buyer; i.e. school bonds, municipal bonds. There are a good number of farms and producers who, although struggling, are meeting their obligations. The long term credit they use is the most important factor in their management equation.

If we can protect long term credit, improve their income, ease their interest rate, and stop the slide in real estate values, we will do a service to all of America!

The problem is not unsolvable - the only obstacle would be the obstinance of any one group. All the various factions within the Farm Credit System must work together. When we look at what we can do, we can pick out a lot of things that should be considered that are positives and should modify the panic and paranoia. Farmers should get, and I venture to say will get, credit for their operation next year. The bottom line of that prediction is, Mr. Chairman, that with the guaranteed lender program you could have long term guarantees where-by the commercial banks could underwrite a majority of the long term credit. It would require somewhat higher loan limit guarantees. But it would in fact serve as an interim credit vehicle for producers if interest rates for Farm Credit should balloon because of burgeoning costs.

Mr. Chairman, long term credit is the most important factor in the management tools a producer must deal with.

We must act on this even if it requires a special session.

Not to act could bring chaos that will spread to all of America.

To act in time means stability for all America.

Testimony of
Senator Tom Harkin
before the
House Subcommittee on Conservation, Credit and Rural Development
September 11, 1985

Mr. Chairman, thank you for this opportunity to testify on this important matter. I will briefly address some of my views on the farm credit situation and then specifically discuss legislation which I have introduced in an attempt to address the farm credit crisis.

I am certain that my colleagues from Iowa here on the Subcommittee have kept you abreast of the farm credit developments in our state, but I would begin today by reiterating that the situation continues to deteriorate. A substantial percentage of our farmers, as many as one-third by some estimates, are on the brink of insolvency. Farm income continues to decline as the real prices received by farmers are at or near record lows for all the principal commodities produced in Iowa -- corn, soybeans, cattle and hogs. Farmland values, which according to the most recent USDA data have declined 49% since 1981, continue to decline as more and more land is forced onto the market and prospective buyers sit on the sidelines waiting for land values to decline even further.

In short Mr. Chairman, we're dying in Iowa. The rapid acceleration of farm and farm business failures that is now occurring is bound to be even greater this fall and winter unless something is done and done now to stem the tide.

Some have suggested that those farmers now in trouble were speculators who gambled and lost and that the government should not now intervene. Let me assure you that this notion is nonsense. Those farmers who expanded too fast or speculated on ever increasing land values are now gone -- they're either in bankruptcy court or have already been liquidated. In Iowa we're now seeing the cream of our farming population being pulled under. They are in many cases family farmers whose ancestors farmed the same land 100 years ago and who have successfully farmed their land for 30 years or more. They are family farmers who didn't buy land or expensive new machinery in the past 10 years. They are family farmers,who because of low farm prices and maybe a drought or two,have had to repeatedly dip into their equity to continue to finance their operations. Yes, many of these farmers are now facing liquidation.

Let's remember that the root cause of this problem is the lack of farm income during the past four years, and until we address that problem, any farm credit legislation will simply be pouring good money after bad. In this regard, I congratulate the Committee on Agriculture for your courageous action yesterday which will give the farmers themselves the tools to improve farm income.

In contrast, waiting for the Reagan Administration to improve farm income is like waiting for the next ice age. At best, their handling of the farm economy has been gross mismanagement. At worst, it is a deliberate attempt to drive family farmers from their land.

At the heart of the farm credit crisis has been the disasterous decline in farmland values.

During the first week of July, my staff, assisted by Iowa State University personnel, conducted a study of land price changes in four Iowa counties.

The purpose of the study was to analyze land selling prices in 1980-1981, as compared to land selling prices since January 1, 1985. Those prices were then compared with the land value based on the income capitalization or cash-flow formula.

The income capitalization method is based on the annual net income from the land, divided by the capitalization value.
This value would be, by definition, the value at which the land could cash-flow or service this amount of debt, as long as the farmer achieved the average yield and price.

The Iowa study was conducted on four farms in Marion County, fourteen farms in Story County, ten farms in Marshall County, and three farms in Wayne County. The total number of farms evaluated was 31, of which 26 sold for less than the income capitalization value. All farms evaluated had been sold since January 1, 1985.

MARION COUNTY
Farm Size: 120 Acres
Estimated Selling Price 1980-1981 $1,800
Selling Price after January 1, 1985 $750
Value of land under Income Capitalization $880
Selling Price percent of Income Capitalization 85%

STORY COUNTY
Farm Size: 100 Acres
Estimated Selling Price 1980-1981 $2,600
Selling Price after January 1,1985 $1,056
Value of land under Income Capitalization $1,685
Selling Price percent of Income Capitalization 62%

MARSHALL COUNTY
Farm Size: 174 Acres
Estimated Selling Price 1980-1981 $3,200
Selling Price after January 1, 1985 $1,029
Value of land under Income Capitalization $1,875
Selling Price percent of Income Capitalization 54%

WAYNE COUNTY
Farm Size: 160 Acres
Estimated Selling Price 1980-1981 $1,500
Selling Price after January 1, 1985 $718
Value of land under Income Capitalization $944
Selling Price percent of Income Capitalization 76%

This study strongly suggests that farmland is now selling in Iowa in some instances at values well below its expected income producing values. Despite this situation, land values are still declining which has the effect of drawing more and more farmers into financial difficulty as balance sheets are adjusted to reflect these deflated land values.

Several alternative solutions have been proposed to address the farm credit crisis.

Some of the proposed solutions would form a new quasi-public/private agriculture lending entity -- like an Aggie Mae that would take ownership of agricultural lands and reduce farmers to renters or sharecroppers for some five to ten years, during which period the farmer would retain leasehold rights and repurchase options.

Another proposed solution would provide up to $5 billion to the Farm Credit System to enable the system to use a newly formed corporation to purchase non-performing loans and in all likelyhood, liquidate them.

Both of these proposed solutions are equally bad for family farmers. Both would separate farmers from their land and have the potential for further declining land values. In addition, the latter proposal would not deal with loans held by banks of other lending institutions.

The criteria I used in drafting S.1340, the Agricultural Land Stabilization Act were as follows:

1. We must stabilize land prices. We must prevent the farm credit system, banks and their regulators from devaluing the value of land below its income producing or cash-flow value. It is true that farmland that sold for $4,000 per acre in 1981 was too high. On the other hand, that same land selling for $1,100 per acre is too low.

2. Our first priority in dealing with the farm credit crisis should be to directly aid family farmers, not to bailout the bond holders of the Farm Credit System or agricultural lenders in general.

3. Any solution should not require family farmers to give up title to their land as a condition for assistance.

4. We must not limit our assistance to borrowers of the Farm Credit System. In my state, a number of banks are failing or are having severe problems.

5. All parties(the government, the lender, and the farmer himself) who contributed to the problem must be required to contribute to the solution.

The benefit of my legislation will be to help family farmers by reconstructing loan amounts in line with income potential and reduce the interest rate paid by farmers to the FmHA rate. This solution will help banks and credit institutions by enabling them to sell all of their viable non-performing loans, although some of the loan amounts will have to be discounted by the credit institutions. The institutions still may recover more out of their non-performing loans than if the loans were to be liquidated.

In addition, this legislation would serve to stabilize and shore up land values because potential land purchasers would be competing with farmers who will now be able to finance their land at its cash-flow value.

And finally, this legislation would not require the creation of a new government entity, but would make maximum use of an existing agency that already has plenty of experience dealing with family farmers, that being the Farmers Home Administration.

Again Mr. Chairman, thank you for this opportunity to testify, and I hope you will give the elements of this legislation your consideration as your Subcommittee proceeds to draft this important farm credit legislation.

(Attachment follows:)

Acc Harkin

PROVISIONS OF S.1340

1. -- Security for Loans Based on Agricultural Value of Land -- When land is used to secure loans by the FmHA, Farm Credit System and federally-chartered banks, these institutions will be required to carry the value of the land for collateral purposes at no less then the agricultural value of the land as determined by income capitalization.

2. -- Agricultural Land Use Requirement -- When a loan is made under provision three, four or five the owner must agree to use the land for: the production of agricultural commodities, wildlife food and habitat, soil or water conservation, or other agricultural purposes approved by the Secretary of Agriculture.

Also, the owner must enter into a covenant with the Secretary, not to exceed forty years, that prohibits the owner from using the land for non-agricultural purposes. These non-agricultural rights can be purchased at the market value from the Secretary at any time.

3. -- Conditional Cancellation of Loan Amounts Based on Non-Agricultural Value of Land -- Portions of loans made by the FmHA which exceed the agricultural value of land may be canceled. The Secretary may cancel the non-agricultural portion and the remaining portion of the loan will become the new loan value owed by the farmer. The interest rate used on the new loan will be the original rate or the rate at time of loan cancellation, whichever is the lesser.

4. -- Purchase of Loans from Farm Credit Institutions
On request from the borrower, FmHA shall offer to purchase a loan from an institution that is placed in bankruptcy or receivership, or is in the process of foreclosing on the borrower's loan as the result of a borrower default.

Loans will be purchased according to the percent assets to debts. There are three catigories: 110% and up, 90% to 110%, below 90%.

110% and up -- FmHA shall offer to buy 100% of the outstanding loan from the troubled institution, less any stock requirement the borrower had to purchase to receive the loan. This is the only case where the borrower does not have to give up the non-agricultural rights to the land.

90% to 110% -- FmHA shall offer to buy 100% of the outstanding loan from the troubled institution, less any stock requirment the borrower had to purchase to receive the loan.

Below 90% -- FmHA shall offer to buy the loan for an amount equal to the agricultural use value of the land as determined by the income capitalization method.

However, if in any case the institution does not accept the offer, FmHA may provide a loan to the borrower in an amount not to exceed the value of the assets of the borrower, to enable the borrower to bid on the assets when put up for sale.

5. -- Purchase of Agricultural Land -- If the market value of land in an area is less than the agricultural value of the land, FmHA may provide a loan up to the agricultural value of the land to family farmers to purchase the land.

6. -- Use of Surplus Agricultural Land -- If FmHA has acquired or acquires land as a result of a foreclosure, they cannot, before October 1, 1989, sell the land at a price less than the agricultural value of the land, or lease the land to grow a commodity which sold for less than the parity price in the preceding year. During this time FmHA will be required to apply all adequate conservation measures to the land.

AGRICULTURAL LAND VALUE STABILIZATION ACT OF 1985

The purpose of the bill is to bring stability to agricultural land prices by providing or restructuring loans to farmers and ranchers in areas with troubled banks or Farm Credit System institutions, in areas with low land prices, or in cases of borrower default

There are six main provisions in this bill. These provisions are based on the use of the income capitalization method to find an agricultural value of land.

Example: Income Capitalization Formula

The income capitalization method is based on the annual net income from the land, divided by the capitalization rate. FmHA, under the Secretary of Agriculture, will consider yields, prices, cost and interest rates for the prior ten years in developing land values.

The following is a simplified example using the income capitalization method to find the Agricultural Land Value.

Price of Corn: $2.64 This is the previous ten year national average of the price received by farmers.

Capitalization rate: 8.375% This is the discount rate used for all water resource and other natural resource projects. It is used for example only. The Secretary of Agricultural would determine actual capitalization rate to be used.

Cost of production: The cost of production used in the example is a multi-year average of the cost of production in Iowa based on USDA-SCS Crop Budget and university studies. Three production levels are used: 115 Bu.Per Acre, 140 Bu Per Acre, 160 Bu Per Acre. All costs except cost for land are taken into consideration. The following are the costs used for this example:

115 bu/acre	140 bu/acre	160 bu/acre
$220.29	$234.75	$242.65

Gross income = yield x price

$303.60 = 115 x $2.64 ....115 bu/acre
$369.60 = 140 x $2.64 ....140 bu/acre
$422.40 = 160 x $2.64 ....160 bu/acre

Net income = Gross income - Cost of Production

$83.31 = $303.60 - $220.29 ....115 bu/acre
$134.85 = $369.60 - $234.75 ....140 bu/acre
$179.75 = $422.40 - $242.65 ....160 bu/acre

AGRICULTURAL VALUE OF LAND

The agricultural land value is found by dividing net income by the capitalization rate.

	net income		cap rate		ag land value
115 bu/acre land	........$83.31	/	.08375	=	$994.74
140 bu/acre land	.......$134.85	/	.08375	=	$1657.91
160 bu/acre land	.......$179.75	/	.08375	=	$2146.26

With this method FmHA will be able to find the agricultural value of any piece of land in the country.

STATEMENT BY SENATOR CHARLES GRASSLEY

MR. CHAIRMAN, MEMBERS OF THE COMMITTEE, I APPRECIATE THIS OPPORTUNITY TO JOIN YOU TODAY TO DISCUSS THE SERIOUS PROBLEMS FACING THE FARMER-STOCKHOLDERS WHO HAVE BORROWED FROM THE FARM CREDIT SYSTEM. JUST THIS PAST FRIDAY, I CHAIRED A HEARING IN IOWA TO STUDY THE PROBLEMS FACING THE FARM CREDIT SYSTEM AND ITS BORROWERS. THE HEARING LASTED NEARLY NINE HOURS, AND WE COVERED A LOT OF TERRITORY.

I WILL BE POURING OVER THE RECORD BEFORE DRAWING ALL MY CONCLUSIONS, BUT I DO WANT TO SHARE WITH YOU SOME OBSERVATIONS THAT SHOULD BE HELPFUL TO YOU AS WELL AS THOSE OF US IN THE SENATE WHO ARE WORKING FOR A RESOLUTION OF THESE PROBLEMS.

FIRST, FARMER-STOCKHOLDERS, AS WELL AS PAST AND PRESENT BOARD MEMBERS AND PROFESSIONAL MANAGERS OF THE FARM CREDIT SYSTEM HAVE EXPRESSED SERIOUS CONCERN THAT THEY HAVE BEEN KEPT IN THE DARK; THAT THEY HAVE BEEN OFFERED ULTIMATUMS, NOT ALTERNATIVES; AND THAT EFFECTIVE CONTROL OF THIS COOPERATIVE LENDING INSTITUTION HAS BEEN TAKEN AWAY FROM THEM AT THE GRASS ROOTS LEVEL.

I MIGHT ADD, ALSO, THAT THIS FEELING IS NOT LIMITED ONLY TO THOSE IN MY STATE OF IOWA AND THE REST OF THE 8TH DISTRICT WHICH IS FACING SEVERE ECONOMIC HARDSHIPS. YOU ONLY NEED TO LOOK AT "PROJECT 1995" TO REALIZE THAT THE TOP LAYER OF PROFESSIONAL MANAGERS OF THE FARM CREDIT SYSTEM HAS THE GOAL OF CENTRALIZING MORE CONTROL INTO THEIR OWN HANDS AND AWAY FROM THE GRASSROOTS. THIS CANNOT BE ALLOWED.

THE SECOND POINT THAT SEEMED TO BE UNDERSCORED BY MY HEARING IS THAT REGARDLESS WHAT WE DO IN WASHINGTON DURING THE MONTHS AHEAD TO HELP BOLSTER THE FINANCIAL CONDITION OF THE FARM CREDIT SYSTEM, THE PROFESSIONAL MANAGERS OF THE SYSTEM INTEND TO MOVE FULL STEAM AHEAD WITH ITS REORGANIZATION AND "BAIL-OUT" PLAN.

THESE OFFICIALS WILL TELL US THAT THEY HAVE NO CHOICE. I AM NOT SO CERTAIN, NOR DO I BELIEVE CONGRESS CAN AFFORD TO ACCEPT THEIR POSITION.

THE REASON IS THAT THEIR BAIL-OUT PLAN INVOLVES WHAT APPEARS TO AMOUNT TO MASSIVE FARM LIQUIDATIONS IN STATES LIKE IOWA AND NEBRASKA WHICH CAN LEAST AFFORD LARGE SCALE DISRUPTION. THE FARM CREDIT SYSTEM HAS SET UP A CAPITAL CORPORATION WHICH WILL TAKE OVER WHAT THEY HAVE DECIDED IS HIGH RISK ASSETS. BUT THE FORMULA USED TO DETERMINE WHAT IS DEFINED AS A HIGH RISK LOAN APPEARS TO BE SEVERELY SKEWED TO PUSH LOAN VALUES DOWN TO UNREALISTIC LEVELS.

FOR INSTANCE, I WAS INFORMED BY ONE OFFICIAL THAT THE LOAN FORMULA DOES NOT GIVE CREDIT FOR FmHA LOAN GUARANTEES. IF THIS IS TRUE, A FARMER COULD HAVE A NINETY PERCENT LOAN GUARANTEE AND STILL BE THROWN INTO THE HIGH RISK CATEGORY, AND THUS END UP IN THE HANDS OF THE CAPITAL CORPORATION.

SYSTEM OFFICIALS ADMITTED THAT THE CAPITAL CORPORATION WOULD LIQUIDATE THESE LOANS AS SOON AS POSSIBLE. THEY ALSO ADMITTED THAT FEWER THAN A DOZEN MEN ACROSS THE

COUNTRY WILL OVERSEE THE CORPORATIONS EFFORTS. SO MUCH FOR GRASSROOTS CONTROL.

THE POINT HERE, HOWEVER, IS THAT THE LOWER THE VALUE PLACED ON THESE LOANS, THE LARGER THE NUMBER OF LIQUIDATIONS THAT WILL OCCUR.

FARM CREDIT OFFICIALS SAID THEY HAD NO ESTIMATES OF THE NUMBER TO BE LIQUIDATED. I HAVE HEARD THAT AS HIGH AS 25 to 30 PERCENT OF THE FEDERAL INTERMEDIATE CREDIT BANK AND PRODUCTION CREDIT ASSOCIATION LOANS IN THE 8th DISTRICT COULD BE LIQUIDATED.

THIS WOULD BRING TREMENDOUS SUFFERING AMONG FARMERS AND WOULD DEVASTATE OUR ECONOMY. IT IS UNACCEPTABLE.

AT THE CLOSE OF THE HEARING, I MADE IT CLEAR THAT I WAS UNWILLING TO WRITE A BLANK CHECK FOR ANY KIND OF GOVERNMENT BAIL-OUT UNTIL I SEE DRAMATIC IMPROVEMENT OVER THE TREATMENT OF OUR FARMERS.

IN SHORT, WE MAY NEED TO SEEK MEANS TO PUT THE SYSTEM'S PLAN OF ACTION ON HOLD UNTIL CONGRESS HAS THE TIME TO WORK OUT AN ASSISTANCE PACKAGE.

IT SEEMS CONGRESS SHOULD ALSO SEEK MEANS OF RETURNING CONTROL BACK INTO THE HANDS OF THE FARMER-STOCKHOLDERS. WE SHOULD ALSO EXPLORE THE MEANS FOR STRONGER REGULATION. THESE TWO RECOMMENDATIONS ARE NOT INCOMPATIBLE. WE NO MORE NEED TO CENTRALIZE THE POWER OF THE FARM CREDIT SYSTEM THAN WE NEED TO CONSOLIDATE OUR NATION'S BANKS INTO ONE

BANK UNDER THE FDIC. THAT IS RIDICULOUS. IF ANYTHING, THE FARM CREDIT SYSTEM, WHICH CONTROLS 35 TO 40 PERCENT OF AMERICA'S AGRICULTURE LOANS, ALREADY HAS TOO MUCH POWER LEFT IN THE HANDS OF ITS TOP LAYER OF PROFESSIONAL MANAGERS.

CONGRESS NEEDS TO EXPLORE THE POSSIBILITY OF CREATING A SEPERATE HOLDING COMPANY, OUT OF THE CONTROL OF THE SYSTEM, WHICH WOULD TAKE OVER HIGH RISK LOANS. BUT UNLIKE THE SYSTEM, THIS ENTITY WOULD WORK WITH THE FARMERS AS MUCH AS POSSIBLE TO KEEP HIM IN BUSINESS, INSTEAD OF LIQUIDATING HIM "AS SOON AS POSSIBLE".

ANOTHER SOLUTION MAY BE TO OFFER GOVERNMENT ASSISTANCE IN BUYING DOWN INTEREST RATES. FARMERS TESTIFIED AT MY HEARING WHO SAID THAT THEY WERE DOING FINE UNTIL THE FEDERAL LAND BANK RAISED ITS INTEREST RATES 3/4 OF A PERCENT. NOW THEY ARE GOING UNDER.

THERE ARE A GOOD NUMBER OF OPTIONS TO STUDY, BUT I BELIEVE THAT IT WILL BE ALL FOR NAUGHT IF WE DON'T FIRST PUT A HOLD ON THE SYSTEM'S PRESENT PLANS. THE ECONOMIES OF THE FOUR STATES OF THE 8TH DISTRICT CANNOT AFFORD MASS LIQUIDATIONS. OUR ECONOMIES COULD BE DEVASTATED. AND YOU CAN BE CERTAIN THAT THE DAMAGE WILL NOT BE LIMITED TO OUR BORDERS. THE DEPRESSING EFFECT WILL SPREAD LIKE WILD FIRE THROUGHOUT THE MIDWEST AND INTO OTHER PARTS OF THE COUNTRY.

SECTION 2001 OF TITLE 12 OF THE U.S. CODE ANNOTATED, CLEARLY SPELLS OUT CONGRESSIONAL OBJECTIVES AND POLICIES WITH REGARD TO THE FARM CREDIT SYSTEM. IT CLEARLY STATES THAT THE SYSTEM WAS ESTABLISHED TO SERVE FARMERS AND BE OPERATED AS A COOPERATIVE BY FARMERS. WE HAVE TO MAKE CERTAIN THAT IT CONTINUES TO MEET THOSE OBJECTIVES.

THANK YOU.

STATEMENT OF U.S. REP. BILL SCHUETTE
BEFORE THE SUBCOMMITTEE ON CONSERVATION, CREDIT AND RURAL DEVELOPMENT OF THE HOUSE COMMITTEE ON AGRICULTURE

SEPTEMBER 11, 1985

Mr. Chairman, I appreciate the opportunity to testify before you today as the subcommittee continues to assess the present condition of the Farm Credit System and the options open to Congress to address its financial problems.

Every one of us wishes that the circumstances were such that this hearing was not necessary. However, the financial condition of the system, highlighted by FCA Governor Donald Wilkinson's recent remarks, make today's hearing of paramount importance.

There's an old saying among Michigan farmers that if you borrow a thousand dollars from the bank and can't pay it back, you're in trouble. But if you borrow a million dollars and can't pay it back, the bank's in trouble.

Well, we are learning that when you borrow multi-billions of dollars and can't pay it back, America is in trouble.

The administrators of the Farm Credit System have long maintained that the system has the financial resources to take care of its own problems. However, this assertion is based upon two fundamental assumptions: the first is that the agricultural economy will continue to support the system, and the second is that the system will continue to quickly consolidate its capital.

Obviously, the first of these assumptions is questionable at best. The farm economy in fact continues to deteriorate. Land values are down 60% in many areas. As the farm economy slides, the

the Farm Credit System loses its ability to function.

May I stress at this point that we are not considering farm credit in a vacuum. The Farm Credit System of the U.S. is intimately tied to the farm economy as a whole. The troubles of the system today are symptomatic of the larger problem, the depression on America's farms.

We have no time to assess blame for the system's woes, and I don't intend to do so. Congress is as culpable as anyone for creating a system without the ability to move cash reserves around when and where necessary, and for not establishing annual outside audits. By permitting loans of up to 97 cents on the dollar, Congress helped to set the stage for large numbers of defaulted loans.

And, the Farm Credit Administration can rightfully be criticized for many of its management practices including loans that were highly questionable.

These practices, and others, have helped to create the situation faced by the system today. We have all heard the frightening statistics, but they cannot be repeated too often: as much as 15% of the system's $74 billion in loans may be uncollectable. System loans that went from $20 billion in 1972 to $66.2 billion in 1980. At least nine of the system's 37 main banks with more problem loans than they have capital. As much as half of the commercial farm debt in this country may be uncollectable.

Land values -- the collateral underpinning most farm debt -- continues to slide, eroding up to half the backing of loans in some parts of the country.

And, it comes as no news to this Committee that the bin-busting harvest expected this fall will continue to push prices downward.

The many farm bankruptcies that result from the farm depression put more land on the market, driving down farm real estate values and thus eroding more land collateral which puts even more farmers in trouble.

We must find solutions to this vicious spiral. To fail to do so threatens the very survival of American agriculture.

The are some actions the government can take that will require very little budgetary outlay. For one, it can require the system to use its billion-dollar reserves to help cover losses.

As my good friend from Iowa, Congressman Cooper Evans has advocated, the Farmers Home Administration should broaden its debt restructuring program to include land mortgages.

Congress should immediately initiate annual outside audits of the FCA, and provide for periodic audits of the system by the General Accounting Office.

The capital level requirement for Farm Credit System institutions is very high when compared to banks. We should examine the merits of reducing the requirement to a level more consistent with other lending institutions.

Congress could authorize new FCS long-term bond issues, to be used for fixed-rate, long-term mortgages.

H.R. 3231, introduced by Congressman Evans, should be enacted into law. It places the full faith and credit of the U.S. government behind FCS bonds and thus would help to shore up investor confidence.

I am pleased to be an original cosponsor of this important bill.

The Farm Credit System itself has proposed major changes, including new regulatory powers to issue cease and desist orders, to levy civil penalties and to remove officers and directors of system banks. Even the creation of a new financial structure has been proposed, and we should carefully consider this option.

Mr. Chairman, we cannot ignore the problems of the Farm Credit System, for they are also the problems of the American farmer and thus the problems of every American. By taking action now, I am confident we can restore the system to sound health and maintain investor confidence without massive infusions of tax dollars.

I urge this Committee to carefully consider the available options and to prudently, but without delay, maintain this vital source of capital for American farmers.

Thank you again for the opportunity to appear before your Committee.

STATEMENT OF THE HONORABLE VIRGINIA SMITH
before the
SUBCOMMITTEE ON CONSERVATION, CREDIT, AND RURAL DEVELOPMENT
SEPTEMBER 11, 1985

Mr. Chairman and members of the committee, I appreciate this opportunity to express the concerns of my constituents in the Third District of Nebraska regarding the Farm Credit System. I commend the Chairman and the Ranking Member, Mr. Jones and Mr. Coleman, for their leadership.

As you well know, Nebraska has been one of the hardest hit states when it comes to farm credit. All of us have read and heard countless statistics concerning this problem. But they bear repeating, for they drive home so well the seriousness of the disaster confronting us. The farm debt picture is vividly frightening:

-widespread occurences of insolvency;
-USDA data shows that one out of every three commercial farms is experiencing severe financial stress;
-One of five commercial farms has a negative cash flow;
-In Nebraska, our farmers are faced with the highest average debt-to-asset ratio of any state.

And we must keep in mind that since these figures were gathered there has been a disastrous downslide in livestock and grain prices:

-Cattle prices are at their lowest levels in seven years;
-Cattlemen in Nebraska and across the nation are losing around $150 per head on fed cattle;
-Wheat and corn prices are below many farmer's production costs;
-Corn is selling at less than $2 for fall delivery in many Nebraska towns.

We can expect the downward pressure on prices to intensify as this year's harvest is brought in. The USDA has predicted bumper crops for US farmers:

-This includes a record-setting corn crop of 8.27 billion bushels or 210 metric tons;
-Total feed grain production for 1985 that is forecast at over 257 million metric tons, 21 million above last year.

Prices of many commodities have already plunged to their lowest levels since 1978, about 15% lower than 1984 levels. And with this economists are predicting a drop in farm income--to between 22 to 26 billion dollars, down from $34.6 billion last year. Obviously when this income shrinks, farmers cannot pay their obligations and face ruin. USDA estimates that about one in three commercial farmers cannot pay his bills.

Already 6 1/2% of the farmers in the 7-state region of the Kansas City Federal Reserve District (which includes Nebraska) went out of business between October 1984 and March 1985. This is an annual rate of 13%. With about 57,000 farms left in Nebraska, this is 7410 per year or 20.3/day--nearly one per hour! This is the most liquidations since the 1930's. Charles Schroeder, director of Nebraska's Agriculture Department, has predicted that "...10-15 percent--or 6,000 to 9,000--of Nebraska's farmers will be 'displaced by liquidation, bankruptcy, or foreclosure in the next six to nine months.'"

Add to this the high value of the US dollar, which has placed a prohibitive "tax" on our export commodities; the worst grasshopper infestation in decades; the most severe drought in parts of Nebraska in 80 years; the most national bank failures since the Great Depression (76 as of September 7, 1985, compared to 79 in all of last year and 48 the year before); and the largest decline in land values in the history of the state (down over 48%).

The list of variables goes on and on. Yet these are only the cold, hard numbers--the facts and figures. There are other more disturbing realities of this urgent situation--the human drama that surrounds farm families when they are forced to leave agriculture--or try to hang on.

A self-sacrificing farm family comments. We are "depriving ourselves of most of life's offerings... ...to pay for those who have failed. God only knows how we are trying. Everything we buy is high. Everything we sell we take what we can get."

A Nebraska farm wife observes her husband. I "looked across the table this noon and my husband's hands looked more like a piece of leather rather than skin. Has lost weight too, will be glad when this slaughter is over..."

And the excerpts of a letter I received from RaeJean Skalicky, a young girl from Verdigre, Nebraska: "...if it weren't for the food pantry in Verdigre we would have to sell out and move...This is because the FDIC takes everyone's money and then gives them nothing to live on..."

These are the very people who have built the foundation of this great country of ours. Many of these families are the descendants of pioneer homesteaders who earned their land the hard way. They came to depend on the financial judgement and guidance of the FCS. We are now finding out that even the FCS has feet of clay.

Now the Farm Credit Administration is talking to the Reagan Administration and Congress about the need for government aid. This follows many months of public assertion that all was well and the system was sound.

Our farmers deserve to be told the truth about the Farm Credit System--the system they purportedly own and control. I hear conflicting reports from both sides. Despite evidence that the FCS has twice as much capital as any commercial banks are ever required to have, spokesmen for the system state that it only has $2-3 billion to cover losses while other reports show they possibly could tap reserves of $6 billion. Senior examiners report that $4.2 billion in liquid government assets could be cashed in as little time as a week to ten days. There is even a dispute within the FCS as to how long before government assistance would be needed.

It is for these reasons that numerous congressional colleagues have joined with me in calling for expediting a GAO audit of the Farm Credit Administration so we can understand just what is happening and have tangible proof of their current financial position. The Wall Street Journal reports that the FCS ..."didn't begin tracking quarterly earnings and loan performance until September 1984, after the agricultural economy had turned many of its loans into basket cases." Unfortunately, even with the effort that GAO is exerting on this project, it will not be finalized for some time.

Financial information that has been disclosed for the system shows several signs of inherent weaknesses. I have some reservations as to the quality of financial data received by the Farm Credit Admnistration. My information shows that 12 active PCA's in the Omaha district had no reserve for loan losses even though the PCA's had a large volume of problem loans. Even if there was a provision for loan losses, the loan losses themselves were often grossly understated. Other information points to associations who have failed to even file a report. My information further is that June 30, 1985, financial data does not reflect the financial difficulties identified during the special credit review of the Omaha PCA's. I question whether an organization of this magnitude can be fair to its owners and investors by not requiring prompt and accurate information consistent with good business and management practices.

Several other factors that impact the future health of the FCS need to be considered. Loan quality, fund availability, customer confidence, and the ability to disperse resources to needy institutions are very important when considering the future of the Farm Credit System. My information suggests clearly that as the spread increases on loan interest rates, the average loss of volume and customer loss increases dramatically.

The Omaha Farm Credit Banks also have another pressing problem. This is that stockholders are concerned that forced consolidation to pool resource funds will take away local control and jeopardize their ownership stock. They could be correct. The FCA has not told anybody anything to alleviate any of these fears. For months now, farmers and ranchers have thought that Omaha would go ahead and build a new $40 million headquarters office. This idea was terminated only towards the end of August, and only after it attracted big, black headlines.

I hope these hearings can produce some answers to some very basic questions. Just what are the Farm Credit Banks doing to lower interest rates for their owner borrowers? Why don't they fully disclose their position and offer to meet with opposing factions to work out a compromise position? It appears that the FCS is almost obsessed with saving the system rather than with serving the farmers and ranchers for whom the system was designed.

As Members of Congress, we must find a feasible solution that would stabilize the farm credit system, supply credit at a competitive interest rate, allow those already in debt some way to remain viable, and reduce the risk that these problems would ever happen again.

While I was back in my District, I repeatedly heard questions as to why should all the stockholders of the Omaha Farm Credit Banks be forced to consolidate into one larger board. They often were not responsible for the problems we now have that are traced to the rapid, frenzied growth of the late 70's. Some farmers recognized that land prices were artificially inflated and were approaching the break-even point regarding profit as to what could be produced on it.

This last generation has had the best chance to experience the American dream--of owning and controlling its destiny. The late 70's brought the chance for farmers and ranchers to expand. FCA's officials encouraged this without understanding what the future might have in store for agriculture. The associations that are hurting now were the most aggressive lenders to the most aggressive farmers.

The Wall Street Journal quotes Herbert Ashton, an Indiana fruit farmer as "being wined and dined at a local country club by bankers from his local system bank who praised the virtues of inflation and offered to lend him $1 million on the spot." Stockholders feel they have been deceived and taken advantage of.

Many producers trusted their loan officers who were persuaded that this was the time to expand--the time to build their futures. Many acres of land were purchased under the auspices of the Farm Credit System. Expensive, overpriced land was being purchased by marginal farmers who were told that their friendly local farm credit lending institution would back them. Then, massive amounts of money were spent for developments like leveling and center pivot irrigation to help make the land more productive. These were ingredients for disaster.

Other instances are evident, such as loans approved without verification of adequate collateral and loans for purposes other than farming. Now, when troubled farmers need the help most, where is their help? It is clear that the demands on the Farm Credit System far exceed its ability to deliver.

Any solution that addresses this problem must: include a means of stabilizing the Farm Credit System, supply a source of credit at competitive interest rates, provide a vehicle that those already in debt have some hope to remain viable, and reduce the risk of this happening again. Furthermore, I strongly believe that this should not be included as a part of the farm bill.

Therefore, I ask you, Mr. Chairman and the subcommittee to push for the enactment of legislation designed to place the Farm Credit System under the same requirements as other Federally regulated lending institutions, especially with respect to the requirements for providing adequate, accurate information.

I also call for congressional blessing, perhaps in the form of a "sense of Congress resolution," that the Federal Reserve System use its power to intercede with appropriate action that may be necessary to save the Farm Credit System if the need arises.

On July 17, 1985, I submitted a concurrent resolution which was referred to the Committee on Agriculture. It expresses a sense of Congress in opposition to the erosion of local control and participation by farmer- and rancher-borrowers in the farmer- and rancher-owned Farm Credit System and in opposition to the large-scale consolidation and mergers of production credit associations and the Federal land bank associations within the Farm Credit System. H. Con. Res. 177 is still open for cosponsorship.

Mr. Chairman, I thank you for allowing me to testify on this great matter of concern to Nebraska and I ask that my testimony be part of the record.

Congressional Rural Caucus

"Members of Congress Working for Rural America"

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11 September 1985

STATEMENT OF CONGRESSMAN IKE SKELTON (D-MO), CHAIRMAN OF THE CONGRESSIONAL RURAL CAUCUS, BEFORE THE SUBCOMMITTEE ON CONSERVATION, CREDIT, AND RURAL DEVELOPMENT, HOUSE COMMITTEE ON AGRICULTURE, 1302 LONGWORTH HOUSE OFFICE BUILDING, WASHINGTON, D.C., ON 11 SEPTEMBER 1985, ACCOMPANIED BY FRANK G. TSUTRAS, DIRECTOR OF THE CONGRESSIONAL RURAL CAUCUS. HEARING CHAIRED BY CONGRESSMAN ED JONES (D-TN).

Mr. Chairman and Members of the Subcommittee on Conservation, Credit, and Rural Development --- in behalf of the Members of the CONGRESSIONAL RURAL CAUCUS --- we commend you for scheduling and conducting these, and additional, public hearings to review and discuss agricultural credit problems which have caused so much hardship and pain on thousands of our farmers and their families throughout the Nation.

At a time when the full House Committee on Agriculture is engaged in daily efforts to write a "1985 FARM BILL", it is certainly obvious that this Subcommittee continues to make known its concern for our farmers and non-farmers in rural areas,

Many people refer to our farm crisis as "the worst times for farming since the days of the Great Depression of the 1930s", especially in those States where much human pain and suffering have been the rule more than the exception.

At this point, I request your permission to include and insert in the official record copies of two (2) special CRC reports on the FARM CREDIT ADMINISTRATION and the FARM CREDIT SYSTEM.

CRC report 9/4/85-64 has been mailed to all CRC Members and to all Members of the House Committee on Agriculture. CRC report 9/11/85-65 was just received from the printer and will be mailed to all CRC Members and to all Members of this Committee today.

For the record, several specific statements are presented for purposes of information and education.

As of 1 January 1984, the FARM NONREAL ESTATE DEBT MARKET SHARES were composed of 38% commercial banks...19% Production Credit Associations and Federal Intermediate Credit Banks - Other financing institutions...18% individuals and others...15% Farmers Home Administration...and...10% Commodity Credit Corporation.

As of 1 January 1984, the FARM REAL ESTATE DEBT MARKET SHARES were composed of 43% Federal Land Banks...29% individuals and others...11% life insurance companies ...9% Farmers Home Administration...and...8% commercial banks.

This means that 44% OF THE FARM NONREAL ESTATE DEBT MARKET SHARES were held by Production Credit Associations, Federal Intermediate Credit Banks - Other financing institutions, Farmers Home Administration, and Commodity Credit Corporation.

This also means that 52% OF THE FARM REAL ESTATE DEBT MARKET SHARES were held by Federal Land Banks and Farmers Home Administration.

As of 31 December 1984, the combined total for loans in the FARM CREDIT SYSTEM was $96.93 BILLION !!! --- including 12 Federal Land Banks for $52.26 BILLION... 12 Federal Intermediate Credit Banks for $17.27 BILLION...13 Banks for Cooperatives for $9.01 BILLION...and...370 Production Credit Associations for $18.37 BILLION.

* The combined total for PERFORMING LOANS was $87.86 BILLION !!! --- including Federal Land Banks for $48.28 BILLION...Federal Intermediate Credit Banks for $14.83 BILLION...Banks for Cooperatives for $8.48 BILLION...and...Production Credit Associations for $16.28 BILLION.

* The combined total for NONPERFORMING LOANS was $9.07 BILLION !!! --- including Federal Land Banks for $3.99 BILLION...Federal Intermediate Credit Banks for $2.45 BILLION...Banks for Cooperatives for $537.8 million...and...Production Credit Associations for $2.1 BILLION.

* The combined total for ALLOWANCE FOR LOSSES ON LOANS was $1.19 BILLION !!! including Federal Land Banks for $547.1 million...Federal Intermediate Credit Banks for $29.3 million...Banks for Cooperatives for $121.2 million...and...Production Credit Associations for $491.2 million.

* Even among commercial banks, the statistics were such that in 1984, reports revealed that 75 COMMERCIAL BANKS WERE PLACED IN LIQUIDATION AND THAT 25 OF THESE COMMERCIAL BANKS WERE CLASSIFIED AS AGRICULTURAL BANKS WITH AT LEAST 25% OF THEIR PORTFOLIO IN AGRICULTURE !!!

* 18 of the 37 commercial banks liquidated during the second half 1984 were agricultural banks, compared with reports that only 5 of the 38 commercial banks liquidated in the first half 1984 were agricultural banks.

FARMERS HOME ADMINISTRATION, an agency of the Department of Agriculture, also has a substantial farm loan portfolio which has had its share of problems and will continue its role as a "lender of last resort" for farmers.

* As of 30 June 1985, with payments credited as of 18 July, FmHA reported that there were 1.48 million borrowers with unpaid principal outstanding of $58.5 BILLION !!! --- including programs such as farm, community, water, waste disposal, business, industry, and rural housing.

There were 377,534 delinquent borrowers. This was 25% of all borrowers.

The delinquent borrowers had unpaid principal outstanding of $18.8 BILLION. This was 32% of all unpaid principal outstanding.

The delinquent unpaid principal outstanding was $6.7 BILLION. This was 35% of unpaid principal outstanding for DELINQUENT borrowers and 11% for ALL borrowers.

* There were 126,453 FARM OWNERSHIP borrowers with unpaid principal outstanding of $7.4 BILLION !!!

There were 31,555 delinquent borrowers. This was about 29% of all borrowers.

The delinquent borrowers had unpaid principal outstanding of $2.24 BILLION. This was 30% of all unpaid principal outstanding.

The delinquent unpaid principal outstanding was $394.5 million. This was 21% of unpaid principal outstanding for DELINQUENT borrowers and 8% for ALL borrowers.

* There were 131,992 FARM OPERATING borrowers with unpaid principal outstanding of $6.0 BILLION !!!

There were 45,947 delinquent borrowers. This was 36% of all borrowers.

The delinquent borrowers had unpaid principal outstanding of $1.92 BILLION. This was 32% of all unpaid principal outstanding.

The delinquent unpaid principal outstanding was $982.4 million. This was 51% of unpaid principal outstanding for DELINQUENT borrowers and 16% for ALL borrowers.

* There were 122,461 EMERGENCY borrowers with unpaid principal outstanding of $9.9 BILLION !!!

There were 54,358 delinquent borrowers. This was 44% of all borrowers.

The delinquent borrowers had unpaid principal outstanding of $6.7 BILLION. This was 58% of all unpaid principal outstanding.

The delinquent unpaid principal outstanding was $3.9 BILLION. This was 58% of unpaid principal outstanding for DELINQUENT borrowers and 39% for ALL borrowers.

* There were 57,468 ECONOMIC EMERGENCY borrowers with unpaid principal outstanding of $4.2 BILLION !!!

There were 27,719 delinquent borrowers. This was 48% of all borrowers.

The delinquent borrowers had unpaid principal outstanding of $2.4 BILLION. This was 48% of all unpaid principal outstanding.

The delinquent unpaid principal outstanding was $1.05 BILLION. This was 44% of unpaid principal outstanding for DELINQUENT borrowers and 25% for ALL borrowers.

Rather than go into more detailed financial comments, permit me to close by assuring you, Chairman Jones, and Members of your Subcommittee, that the CONGRESSIONAL RURAL CAUCUS welcomes the opportunity --- and the challenge --- to continue its excellent working relationship with you, your Members, and your staff.

Thank you.

Statement of
the Honorable Jim Leach
(R-Iowa)

before the
Subcommittee on Conservation, Credit and Rural Development
House Agriculture Commitee

September 11, 1985

This is the winter of reckoning for the Farm Credit System. Some problems by their nature ease with the passage of time. This isn't one. Ignoring the dilemma of farm credit -- as the Administration largely has done -- will not cause the problems to go away. Neither will denying its seriousness -- as the Farm Credit Administration has practiced so mischievously -- contribute to a credible solution to the issues posed.

The question we must all ask ourselves in the first instance is: is the System worth saving; and in the second, assuming the answer to the first question is in the affirmative, who will pick up the tab?

Compassion for the problems of rural America, where in a short five years asset values have been cut in half, despite concurrent national GNP growth, dictates that the Farm Credit System not be only saved, but bolstered. Structural change of a wholesale character may be required; but rural America cannot be left dangling on a cross of misplaced Washington priorities.

The first question therefore can be answered as a societal imperative. The second is more difficult.

To date, Farm Credit System backers have suggested salvation can be found in either of three basic approaches: 1) a substantial capital infusion from Congress -- i.e., the taxpayer; 2) the formation of a government-financed warehouse to accept responsibility for weaker farm credit obligations, presumably from commercial banks and insurance companies as well as the cooperative credit system -- with the prospect for such an approach being enhanced by political pressure being brought to bear by an implicit financial institution debtor's cartel; 3) a Treasury guarantee for all Farm Credit System bonds.

Each or any of the above in combination appear preferable to letting the system sink. But all three approaches have major disadvantages, which make prospect for either Administration backing or majority support in Congress conjectural. It may be bad lck that the farm plight has surfaced with such intensity at a time when federal budgetary flexibility has eroded, but the reality of this bad luck in timing must be recognized and realistic solutions developed which minimize the impact of Washington budget constraints. As attractive, for instance, as warehousing approaches like those advanced by the Farm Credit System may appear to rural America, the fact is they will undoubtedly be viewed by the Administration and an increasingly wary Congress as a lending institution's Nirvana and taxpayer's nightmare. The government simply isn't likely to pick up $30 to $50 billion in bad paper, whether it is described as an off- or on-budget transaction. Taxpayers can be expected to enquire rather boldly of their elected representatives why they should be liable for the lending excesses of commercial banks and insurance companies as well as the poor risk management of the Farm Credit System and the investment mistakes of bondholders.

Accordingly, as profound as the question of whether to save the system is the question of who should foot the bill. I am personally doubtful the taxpayer should be at risk and would suggest that the ultimate burden should more properly be born by the bond holders, who have invested in Farm Credit System bonds knowing the risks and, presumably, the lack of federal guarantee involved. It is nuts for the public at large to take responsibility for the obligations and risks undertaken by the few, the vast majority of whom are professional money managers.

How then can bondholders be held accountable, while assuring confidence and continuation of the system? I would propose the following approach which I expect to introduce shortly as legislation.

1) Under the broad bankruptcy powers it has been granted in Article I of the Constitution, Congress should create an emergency Farm Credit Authority to replace the current Farm Credit Administration. The first duty of this authority should be to utilize the General Accounting Office and/or private accounting firms to assess the degree to which liabilities exceed assets within the System.

2) The Authority should then be empowered to offer bondholders a government guarantee of a percentage of the par value of current bonds outstanding. Such percentage would be based proportionally upon a calculation of system assets, not counting farmer-owned stock, minus liabilities. In return for this loan guarantee, current bondholders would be required to write off entirely the percentage of the bond not guaranteed. The advantage to bondholders is that they would be given a government guarantee for what would probably be at least 80 percent of the value of their bonds. If in the alternative, the system was forced to liquidate assets — a not totally unlikely prospect given current concerns about the deficit -- land and equipment values would surely plummet causing collectable returns for bondholders to decline and only be available after what would certainly be prolonged and expensive litigation. The advantage to the farmer, because of the write down in bond values, would be that the system would no longer be required to charge interest rates substantially above competitive levels currently existent for the rest of the American economy. Financially stronger borrowers in the system would no longer have to compensate through payment of higher rates for the loan losses of their more overstretched neighbors. The current sock-it-to-the borrower policies of the Farm Credit System which have caused the most credit worthy participants to seek credit elsewhere could be reversed.

3) In order to assure orderly marketing of future bonds, the Authority should be empowered to guarantee 100% of future bond sales for a period of time, perhaps five years.

4) The system would in effect be reconstituted with powerful borrowing capacity, fairly appraised assets, and the ability to utilize farmer owned stock in its efforts to rebuild a prudent capital base.

5) In the reconstituted system a new Federal Cooperative Stock Investment Corporation should be established to insure farmer owned stock up to $100,000 as the FDIC and the FSLIC currently do in the banking and thrift industries. Farmer stock, after all, is in effect more analogous to a deposit in a financial institution than a corporate equity investment. It should be protected. Currently the Farm Credit System has the authority to draw on an approximately $260,000,000 revolving fund at the Treasury, such sum representing repayment of the original capital the government put into the system. The newly organized Farm Credit Authority would be empowered to tap these reserves as original capital for the Federal Cooperative Stock Investment Corporation.

6) The reconstituted system would be regulated by the Federal Deposit Insurance Corporation and required to undergo annual FDIC audits, with such audits publicly submitted to Congress.

7) To receive the imprimatur implied with public borrowing guarantees any new system must establish greater resource flexibility, maintain more substantial reserves, be subject to more prudent management guidelines and tighter-fisted audits, and at the same time remain, in principle, locally controlled. Many have ideas how best to achieve such an objectives, but the newly proposed Farm Credit Authority must recognize that national powers are mandatory to oversee audits, negotiate with bondholders, and re-establish confidence in the system, but long term viability depends on the kind of farmer support that can only be generated by maintaining the maximum degree possible of local control. The current system has erred in creating too many autonomous fiefdoms, but going to the opposite extreme -- total nationalization of lending authority -- would also be a mistake. A prudent but sensible balance must be struck.

8) It must be recognized that the Farm Credit System, while the largest actor is but one reflection of the debt problem of rural America. It can not be looked at and dealt with alone. Therefore the Administration has an obligation to establish immediately a Presidential Commission on Farm Credit to look at the full picture. Congress is unlikely to act in a substantive direction without Presidential leadership on issues which carry, as this does, multi-billion dollar implications. What is needed now is a careful survey of options available to the government in the whole area of rural credit and, most of all, impetus given to decision-making. Just as the President's commission on Social Security led to a series of responsible recommendations which were largely adopted by Congress, a Presidential Commission on Farm Credit will force a high level review of the entire agricultural credit system. Key to solving the farm credit problem is profitability. The system is strong as the daylights with $4 corn, $60 hogs, and $75 cattle; it is insolvent with $2 corn, $40 hogs and $55 cattle. Therefore the problems of farm credit are directly linked to farm pricing and indirectly to farm legislation. To simply consider approaches which temporarily underpin credit is worse than a palliative, for the problem doesn't just become postponed; it deepens and potentially electrifies a way of life. A Presidential Commission on Farm Credit cannot duck the profitability issue. It must be addressed.

9) In the wake of the overextension of lending abroad by U.S. money center banks in the 1960's and 70's policies were set in place in the 80's to ensure that debtor countries could repay their loans. Now rural America has become the equivalent of a less developed country within a developed one. The terms of trade have turned against us. Iowa is like Brazil — except that the government has spent more time and effort shoring up the international monetary system than the domestic one. It's time to emphasize the magnitude of the problem for our country as well as the gravity of the problem for the average farm family. In order to save Brazil, Washington has, through a loose fiscal and tight monetary policy, inflated the relative value of the dollar and caused a deluge of imports. To save American agriculture as well as our manufacturing base governmental priorities are going to have to be reversed. It's time for a tighter fiscal policy --i.e., balanced budget — and eased monetary policy. The Federal Reserve can help on a short term basis to temporize the Farm Credit System problem by opening its discount window, but in the long run the most effective assistance it can provide is to induce a weaker dollar.

The major disadvantage of the approach I have outlined is that holding bondholders rather than taxpayers accountable for losses in the system might cause some deterioration of confidence in the American bond markets. This is a risk, but it doesn't strike me as that unrealistic in a free enterprise economy to penalize those who make investments that don't work out perfectly. Prudent investors — in this case, largely financial institutions (18 percent of the bonds being foreign held), money fund managers, and wealthy individuals — should have known: a) that the federal government did not guarantee Farm Credit System bonds; b) that the system had scandalously poor audit controls and operating guidelines (like Continental Illinois Bank even rewarding loan officers with bonuses for making greater numbers of loans); c) that all the capital in the system was tied up in a single, traditionally cyclical industry that had been subject to a wild inflationary push in the 1970's; d) that return on investment in agriculture has been negligible for two decades and that a farm recession has been brewing for the past five years in response to the pro-import, anti-export mix of fiscal and monetary policies established by Washington; e) that there are particular risks inherent in any credit system where boards made up of borrowers accountable to little oversight and salary discipline make credit decisions.

In conclusion, I think it important to stress the moral and philosophical base for a proposal designed in the first instance to save the system and in the second to put the burden of cost on bondholders rather than taxpayers.

The credit crisis facing American agriculture threatens to become epidemic in proportion. The effects of deflation, plummeting land and equipment values, shrinking export markets, overvaluation of the dollar and high real interest rates have crippled the capital base of rural America.

For the first time in this century, agricultural America faces real interest rates -- the difference between the rate charged by lenders and the basic inflation rate -- in double digits. It is no accident that when the cost of interest exceeds the cost of feed, livestock farmers confront insurmountable economic hurdles. No amount of hard work or modern efficiency can make up for the unprecedentedly high cost of capital.

The moral issue that government must address is not one of saving a financial institution but saving the farm economy and preserving a rural way of life. A case can be made that if socially desirable, this should be a taxpayer function, but at issue here is the fact that in a free enterprise economy bond holding investors have benefitted from the fruits of their indirect agricultural investments and it is not unreasonable to think they might be expected to lose 10 to 20 percent of their investment just as the farm community has lost 50 percent of its asset base.

Those that will be marginally penalized include some rural financial institutions which should have understood best the economic problems growing in the farm belt, but most of the investors represent regions of the country or foreign institutions which have benefitted from the very government policies that have devastated rural America. On the basis of equity, as well as the logic of risk taking in our entrepreneurial economy, government should not protect from partial loss those who largely can afford the risks undertaken and who in any event should have known better.

The Farm Credit System should be saved, reformed, and revitalized, but not at public expense.

If Congress is ever to balance the budget, the buck must stop being passed around.

# # # # #

Byron L. Dorgan

TESTIMONY OF CONGRESSMAN BYRON L. DORGAN

NORTH DAKOTA

COMMITTEE ON AGRICULTURE

SUBCOMMITTEE ON CONSERVATION, CREDIT, AND RURAL DEVELOPMENT

SEPTEMBER 11, 1985

Mr. Chairman, I appreciate the opportunity to testify today on the credit crisis facing our farm economy.

The dimensions of the problem are staggering. In my heavily agricultural state of North Dakota, recent figures from the state tax department estimate that net realized farm income in North Dakota will drop by over one-third from 1983 to this year. The value of farmland in my state declined almost 20% from last year to this.

These figures are a microcosm of what has been happening nationwide. Farm income is estimated to drop to $22 billion in 1985, down from $34.6 billion in 1984. It is not surprising that roughly a quarter of the total farm debt now outstanding, $50 billion, cannot be repaid.

The seriousness of this situation, and the implications it carries for the larger economy, cannot be overstated. Just last week, in a dramatic turnaround, the governor of the Farm Credit Administration Donald Wilkinson acknowledged that the system will require a multibillion dollar infusion of federal money to prevent the system from becoming insolvent.

And, of course, the problem is not confined to the Farm Credit System. Over 400 commercial farm banks -- those with more than 25% of their loan portfolio in agriculture -- are now on the regulators' list of problem banks.

Nor is the problem confined just to the agricultural sector itself. If no dramatic steps are taken, the increasing number of failures among small banks in the Midwest could lead to failures among banks in larger financial centers, according to a July report by economists at Wharton Econometric Forecasting Associates. Such a ripple effect could "theoretically spread through the banking system like a contagious disease, eventually causing the financial system to collapse" -- a grim forecast indeed.

So today Congress once again, as we did in March, takes up the serious business of seeking a solution to this problem, and determining an equitable way to pay for that solution.

I believe there are two ways to go about implementing a solution to the farm credit crisis. One is the trickle down approach: pour money in at the top by giving a major infusion of capital to lenders serving agriculture.

The other is a "percolate up" approach, by improving farm income and therefore farmers' loan repayability. This could be done by restructuring federal farm programs to give a greater share of benefits to family-sized farmers, which is the opposite of what we do now. It may be that the current situation in the farm economy has so weakened our agricultural lending institutions that we will have to fashion a solution that does both. But it makes no sense to me just to pour money into the system, without addressing the problem that got us where we are -- low farm income.

Some will say, agreeing with the steely assessment of former Budget Director David Stockman, that farmers got themselves into this predicament, and farmers should therefore get themselves out. But that is not an accurate picture of how farmers got where they are.

The biggest culprit has been this Administration's failed economic policies over the past five years. Misguided supply-side economics, presided over by Mr. Stockman, shaped the current economic climate that farmers now operate in. Real interest rates are at record levels. The huge federal deficit, fueled by the President's 1981 tax reduction plan and subsequent bonanza spending for the military, have saddled us with a federal deficit larger than that accrued under all previous Administrations put together. The budget deficit and resulting high interest rates have pushed up the value of our dollar, with a devastating impact on imports, now expected to hit a six-year low of $32 billion, a decline of 16% in just one year.

At the same time, farm program administration has been disastrous. As John Block lurched from exhorting our farmers to plant all they could in 1981, to the PIK program of 1983, the biggest market intervention program in farm history, farm program costs have quadrupled, skyrocketing from $4 billion in

1981 -- about the same level as each of the preceding four years -- to an estimated $16.8 billion this year.

No, farmers did not design these policies, and farmers alone should not be expected to shovel themselves out from under them.

I would like to share some additional thoughts on some of the principles that should guide as as we look for solutions to these extremely difficult problems, Mr. Chairman.

o As I mentioned above, most importantly we must address the question of increasing family farm income in the Farm Bill now being debated in the House. We cannot afford the kind of reductions that the Administration's farm bill, or variations of it, would bring to farm income. We should not lose sight of the fact that low farm income is a direct cause of uncollectable farm debt. We need to trade trickle down economics for some "percolate up" economics.

o We must maintain the current family farm structure of agriculture in this country. Japan and Western Europe have adopted public policy which states that a network of family farms is essential to their national security, and I believe we must, too. Any farmland holding mechanism, for instance, should be targeted to family and beginning farmers, and not toward off-farm investors.

o We must be aware of the social disruptions and larger economic costs to the fabric of our society if the federal government does not address the current crisis in farm credit. This is not simply a problem that is revealed in farm debt and bank ledger numbers. It is a problem that shows up in increased alcohol abuse and family stress; in rural communities slowly dying as their main street business close one by one.

o Over the long term, we must seek an integrated fiscal and monetary policy that reduces the forces that have been so devastating to today's agriculture. This Administration must accept the blame for much of agriculture's current dilemma, and therefore help restore the farm credit system to sound financial footing.

STATEMENT OF THE HONORABLE HAL DAUB

SEPTEMBER 11, 1985

BEFORE

THE SUBCOMMITTEE ON CONSERVATION, CREDIT AND RURAL DEVELOPMENT

OF THE

HOUSE COMMITTEE ON AGRICULTURE

MR. CHAIRMAN, MEMBERS OF THE SUBCOMMITTEE, I AM PLEASED THAT YOU HAVE DECIDED TO CONVENE THIS PUBLIC HEARING TO EXAMINE THE PROBLEMS AFFLICTING OUR FARM CREDIT SYSTEM.

PRIOR TO COMING TO THE HOUSE, I WORKED FOR OVER A DECADE IN AGRICULTURE AND WITH FARM CREDIT SYSTEM LENDERS. ALTHOUGH NOT A MEMBER OF THE AGRICULTURE COMMITTEE, I HAVE CONTINUED TO BE INTERESTED IN THE FARM CREDIT SYSTEM.

FOR SOME TIME NOW, I HAVE BEEN SPEAKING WITH OTHER INTERESTED COLLEAGUES IN THE HOUSE, MEETING WITH ADMINISTRATION OFFICIALS AND REPRESENTATIVES OF THE FARM CREDIT SYSTEM INCLUDING GOVERNOR WILKINSON ABOUT THE FINANCIAL INBALANCES NOT ONLY IN THE OMAHA DISTRICT BUT SYSTEMWIDE.

IN ONE SENSE THE TROUBLES AFFECTING THE SYSTEM REFLECT THE FUNDAMENTAL PROBLEMS BESETTING AGRICULTURE GENERALLY. A CONFLUENCE OF LOST EXPORT MARKET BECAUSE OF TRADE EMBARGOES AND A HIGH DOLLAR, ADVERSE WEATHER, HIGH INTEREST RATES DRIVEN BY HIGH GOVERNMENT SPENDING, SHORTSIGHTED AND INFLEXIBLE FARM POLICY, CHANGING DIET TRENDS, PLUNGING LAND VALUES, AND JUST PLAIN BAD LUCK HAVE RESULTED IN EXTRAORDINARY INDUSTRY STRESS. NOT SURPRISINGLY, THIS STRESS HAS MANIFESTED ITSELF IN THE LARGEST HOLDER OF AGRICULTURE DEBT, THE FARM CREDIT SYSTEM.

FARMERS, RANCHERS AND THEIR SERVICE INDUSTRIES HAVE SERIOUS CASH-FLOW PROBLEMS BECAUSE OF LOW PRICES AND LARGE DEBT SERVICE REQUIREMENTS. GROSS FARM INCOME IS EXPECTED TO DROP MORE THAN 30% THIS YEAR CLOUDING THE PROSPECTS ABOUT FARMERS ABILITY TO SERVICE THEIR 212 BILLION DOLLAR DEBT.

I SHOULD ADD THAT ACCORDING TO USDA MORE THAN 80% OF ALL FARMS HAVE DEBT TO ASSET RATIOS OF LESS THAN 40% -- REASONABLY TOLERABLE LEVELS. IT IS THE REST OF THE BORROWERS, ROUGHLY 20%, WHICH IS CONCENTRATED IN THE MIDWEST THAT FACE SERIOUS FINANCIAL DIFFICULTIES. IN NEBRASKA, FARMLAND VALUES HAVE DECLINED 50% SINCE 1981.

THE FARM CREDIT SYSTEM IS THE LARGEST FARM LENDER. MUCH OF ITS LOANS ARE SECURED BY THIS DETERIORATING FARMLAND COLLATERAL.

FIGURES WERE JUST RELEASED FOR THE SECOND QUARTER ENDING JUNE 30. LOSSES FOR THE FIRST SIX MONTHS OF 1985 WERE SOME $206 MILLION. THIS COMPARES TO A $41 MILLION LOSS FIGURE FOR THE FIRST SIX MONTHS OF 1984. ANTICIPATED LOSSES ON THE YEAR IS NOW PROJECTED BETWEEN $600-900 MILLION. THE COMPARABLE FIGURE FOR 1984 WAS $447 MILLION.

THE SYSTEM HAS BEGUN TO RESPOND TO ITS PROBLEMS. CONSOLIDATION IS UNDERWAY. THE FARM CREDIT ADMINISTRATION JUST APPROVED A REGULATION ALLOWING IT TO INITIATE FUNDING TRANSFERS AMONG LENDERS TO ASSIST FALTERING SYSTEM BANKS AND ASSOCIATIONS.

THE SYSTEM HAS APPROVED A 340 MILLION DOLLAR ASSISTANCE PACKAGE FOR THE OMAHA DISTRICT. I WAS PLEASED BY THIS DEVELOPMENT. HOWEVER, IN LIGHT OF GOVERNOR WILKINSON'S RECENT COMMENTS, AND THE NUMBERS WE ARE NOW RECEIVING, THIS IS NOT GOING TO BE SUFFICIENT.

I UNDERSTAND THAT THE FEDERAL FARM CREDIT BOARD OF THE FCA HAS SCHEDULED A BOARD MEETING IN OCTOBER TO DISCUSS OPTIONS FOR AN ASSISTANCE PLAN. IT APPEARS THE SYSTEM CAN COVER ITS LOSSES FOR THE NEXT NINE TO TWELVE MONTHS BUT THE OUTLOOK BEYOND THAT IS UNCERTAIN.

PART OF THE PROBLEM IS THAT WE DON'T YET KNOW THE TRUE EXTENT OF IT. OUTSIDE AUDITS ARE UNDERWAY. BUT ANYTHING THIS SUBCOMMITTEE CAN COMPILE TO SHED LIGHT ON THE MAGNITUDE OF THE CHALLENGE WE FACE WOULD BE INVALUABLE.

I AM ENCOURAGED BY THE ATTENTION THIS SUBCOMMITTEE IS GIVING THIS SITUATION AND AN EXAMINATION OF THE OPTIONS BEING DISCUSSED IN ADVANCED OF THE PRESENTATION OF THE FCA RECOMMENDATION EXPECTED THIS OCTOBER IS WELCOMED.

SOME QUESTIONS I URGE YOU TO ADDRESS FOLLOW.

> WHAT IS THE EXTENT AND AVAILABLITY OF CURRENT LOAN RESERVES? I HAVE SEEN FIGURES ANYWHERE FROM ONE TO SEVEN BILLION DOLLARS IN THE SYSTEM TO COVER LOAN LOSSES. WE NEED TO KNOW HOW MUCH IS AVAILABLE AND MORE IMPORTANTLY, HOW MUCH IS LIQUID ENOUGH TO APPLY TO CURRENT AND PROJECTED LOSSES.
>
> CURRENTLY FCS HAS RESERVE REQUIREMENTS EXCEEDING COMMERCIAL LENDERS BY TWO OR THREE TIMES. THERE IS GOOD REASON FOR THIS. THE NONDIVERSE PORTFOLIO OF FCS MEANS THERE IS GREATER RISKS INHERENT IN THE SYSTEM. THE SUBCOMMITTEE MIGHT CONSIDER THE POSSIBLITY OF LOWERING THESE REQUIREMENTS POSSIBLY ACCOMPANIED BY PERMITTING LIMITED PORTFOLIO DIVERSICATION.

ANY CONGRESSIONAL ASSISTANCE SHOULD INCLUDE SIGNIFICANT FEDERAL OVERSIGHT REFORM. GREATER OVERSIGHT OF THE MONEY MANAGEMENT PRACTICES OF THE SYSTEM IS A MUST. THE CURRENT SITUATION HAS HIGHLIGHTED HOW VITAL THE SYSTEM IS TO THE AGRICULTURE COMMUNITY. MORE STRINGENT REVIEWS WILL BE NEEDED TO MONITOR BOTH THE PROGRESS OF THE SYSTEM THROUGH ITS CURRENT PROBLEMS AND TO GIVE AMPLE WARNING OF FUTURE STORM CLOUDS.

THERE HAS BEEN CONSIDERABLE TALK ABOUT CREATION OF A NEW ORGANIZATION TO WAREHOUSE MARGINAL LOANS OR ASSETS OF TROUBLED FINANCIAL INSTITUTIONS. I AM CONCERNED THAT WE MIGHT CREATE "A LAND AND EQUIPMENT ASSET RESERVE" WHICH HOLDS DOWN MARKET PRICES. WE HAVE SEEN THIS PROBLEM WITH GOVERNMENT STORED COMMODITIES. PERMITTING LAND AND EQUIPMENT VALUES TO RISE AGAIN MUST BE A MAJOR OBJECTIVE.

IF THIS OPTION IS SERIOUSLY CONSIDERED, PERHAPS THIS PROBLEM COULD BE ADDRESSED BY ENSURING ORDERLY SELL BACK PROVISIONS. THE ORIGINAL FARMER SHOULD BE GIVEN THE FIRST RIGHT OF REFUSAL TO BUY BACK THE PROPERTY AT THE END OF A SPECIFIED PERIOD.

I HAVE BEEN TOLD THAT A DIRECT INFUSION OF FEDERAL ASSISTANCE MAY BE LESS COSTLY THAN A NEW CORPORATE HOLDING COMPANY. IT WOULD OBVIOUSLY AVOID THE FARMLAND STORAGE PROBLEMS I JUST ALLUDED TO.

WE MUST REMEMBER THAT CONGRESS IS REALLY THE CULPRIT BEHIND THE FARM CREDIT SYSTEM'S WOES. HIGH GOVERNMENT SPENDING HAS DEALT THE FARMER AND SYSTEM DOUBLE BLOWS. IT HAS SHRINK EXPORT MARKETS WITH A SKY HIGH DOLLAR AND FOISTED ENORMOUS INTEREST PAYMENTS ON THE PRODUCER.

ULTIMATE STALBITY IN THE FARM CREDIT SYSTEM AND THE AGRICULTURE COMMUNITY IN GENERAL WILL ONLY ARRIVE WHEN WE STAND ON THE FLOOR OF THE HOUSE AND MAKE THE HARD SPENDING CHOICES NEEDED TO REDUCE INTEREST RATES. THE KIND OF PAIN AND DISLOCATION THAT IS OCCURRING IN RURAL CREDIT MARKETS CAN REALISTICALLY BE LAID AT AT ONLY ONE DOOR FELLOW COLLEAGUES: OURS!

I THANK YOU FOR YOUR ATTENTION.

September 11, 1985

TESTIMCNY OF CONGRESSMAN JIM LIGHTFOOT BEFORE HOUSE AGRICULTURE SUBCOMMITTEE ON CONSERVATION, CREDIT AND RURAL DEVELOPMENT

Mr. Chairman, members of the Committee, let me thank you for the opportunity to testify before you today on the subject of farm credit problems.

Having contacted your Subcommittee earlier this year to request your investigation of the farm credit situation, I am grateful that you've chosen to look into this critical problem.

I first became involved in this issue some months ago when farmers in my district were having difficulty securing funds for spring planting. In the midst of several farm bank closings, I put together town meetings with panel discussions in which Farm Credit System officials agreed to take part, along with commercial lenders and officials from the Farmers Home Administration. At these meetings, frustration surfaced when questions from the audience were answered by FCS officials with vague replies, confusion and no straight answers.

By that time, around the first week of July, problems within the Farm Credit System appeared to be growing. While I had scheduled a trade mission trip to Japan, I cancelled the trip to go back to Iowa to further investigate the situation. I held four town hall meetings across my district which were heavily attended.

The messages I got were disturbing to say the least -- no forebearance, farm member control was being usurped by hired staff, no information was being released to members. For example, the South Central PCA in Iowa put members' stock into liquidity when stock was frozen. Liquidation started in January but no one knew this until the May 13th announcement that the stock had been frozen.

Our office receives many, many examples of lack of forebearance. People have been foreclosed because one payment was late. In some cases, alternative financing is not even being considered -- "foreclosure, foreclosure" seems to be the cry.

Management of the Farm Credit System refuses to accept any responsibility for the condition of the system, instead pointing fingers at the general farm situation and Congress for not coming out with a Farm Bill. This attitude has been widely reflected in press reports over the past few days.

Yet, with lack of information on the internal status of the system, it's a little difficult to prescribe a remedy. That's why I joined some of my colleagues in requesting a GAO investigation and audit of the Farm Credit System.

As you may be aware, my Government Operations Subcommittee on Government Information, Justice and Agriculture held a hearing in July inviting officials from the banking industry and the Farm Credit System to testify on the subject of agricultural credit problems. As well, last week I appeared before Senator Grassley's Judiciary Committee to discuss this situation.

These hearings have brought to light several important facts:

1 -- The FCS System management isn't aware of what is happening inside the system. They are unaware of foreclosure procedures and didn't know about letters which were sent out to members. They were also uninformed about liquidation of PCA property and about the South Central PCA situation I described earlier.

2 -- The Farm Credit Administration has absolutely no power; they can identify a problem but can do literally nothing to solve the problem. For example, a number of irregularities have turned up, such as a house in the city financed through the Omaha Federal Land Bank. In that particular case, the member's name was released to a wide number of people.

3 -- Poor internal accounting has allowed huge losses to be overlooked. To mention one oversight, Price Waterhouse discovered $50 million dollars in losses in the Omaha Federal Land Bank that had been overlooked. Instead of a first six months profit of $2.7 million, a loss of $47.3 million should have been shown.

It's obvious that the system needs responsible regulation. FCA must be given some power in this area. This will have to be a first step -- we need to get a rulebook that everybody will play by.

The management of the Farm Credit System must be evaluated at all levels and necessary changes must be made.

Careful and accurate evaluation of the financial condition of the system must be made to determine where funds can be shifted and how. The GAO audit will be of some assistance in this regard, however, thorough completion of that audit is going to take a great deal of time -- that's something we don't have.

Recent media reports have brought to light the fact that land values in Iowa have fallen more perhaps than in any state in the country. This helps to explain the dire condition of the Omaha District of the Farm Credit System when compared to other FCS districts, not to mention the frustration I've incurred in my efforts to address the credit problems my farmers are facing. With the Farm Credit System representing 40% of agricultural borrowing, actions by the System have perhaps greater impact on my farmers than any other factor.

I find it outrageous that officials within the Farm Credit System have for months told myself and other Members of Congress when we expressed concern, that the System can take care of its problems internally with no immediate help from the federal government. Yet last week, FCS Governor Wilkinson is quoted in the Wall Street Journal that the System will require a massive federal bailout. Meanwhile the System aggressively pursues farm liquidations to rid themselves of any "problem" loans.

All of this leads me to one conclusion: while the Farm Credit System may ultimately need a "bail-out", such a financial aid package should be a last resort. Our role cannot be to save the System at any expense, which is what FCS management seems to want to do -- our role must be to help provide farmers with adequate credit at reasonable cost, in order to preserve American agriculture. We must protect the farmer members of the Farm Credit System and the communities that depend on them.

Thank you, again, for the time to share my concerns with the Committee.

INC
COMMUNICATING FOR AGRICULTURE

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TESTIMONY BEFORE FOR THE HOUSE AGRICULTURE COMMITTEE SUBCOMMITTEE ON CONSERVATION, CREDIT AND RURAL DEVELOPMENT

REVIEW OF AGRICULTURAL CREDIT CONDITIONS

September 11, 1985

PRESENTED BY:

N. Rollie Lake, President
Communicating for Agriculture

MR. CHAIRMAN, MEMBERS OF THE COMMITTEE:

MY NAME IS ROLLIE LAKE, AND I AM PRESIDENT OF COMMUNICATING FOR AGRICULTURE. WE ARE A NONPARTISAN RURAL MEMBERSHIP ORGANIZATION WITH MEMBERS IN OVER 40 STATES.

CA IS AN ORGANIZATION WORKING FOR AND SPEAKING FOR AGRICULTURAL AMERICA. WE ARE BASED IN FERGUS FALLS, MINNESOTA.

CA IS IN ADDITION TO AND NOT IN PLACE OF ANY OTHER FARM OR RURAL ORGANIZATION. CA STRIVES TO UNITE AND NOT DIVIDE AGRICULTURAL AMERICA.

WE APPRECIATE THE OPPORTUNITY TO ONCE AGAIN APPEAR BEFORE THIS SUBCOMMITTEE AND TO TAKE PART IN TODAY'S HEARING ON AGRICULTURAL CREDIT CONDITIONS.

MR. CHAIRMAN, SINCE THE LAST TIME WE APPEARED BEFORE THIS SUBCOMMITTEE ON THE ISSUE OF AGRICULTURAL CREDIT, CONDITIONS HAVE SERIOUSLY DETERIORATED.

THE CRISIS HAS DEEPENED IN AGRICULTURAL AMERICA. IT IS A CRISIS OF TROUBLED FARM DEBT FOR THE AMERICAN FARMER AND OF CLASSIFIED ASSETS FOR AGRICULTURAL LENDERS. IT IS A CRISIS WHICH MUST AND CAN BE MET.

WE COMMEND THE CHAIRMAN AND THIS SUBCOMMITTEE FOR THE COURAGEOUS ACTION WHICH WAS TAKEN LAST SPRING CONCERNING THE FARM CREDIT

CRISIS AND FOR THE CONTINUED VIGILANCE WHICH THIS HEARING TODAY REPRESENTS.

THERE ARE A LARGE NUMBER OF FARMERS WITH TROUBLED DEBT WHO ARE IN VARIOUS STAGES OF FINANCIAL DIFFICULTY. FOR MANY OF THESE FARMERS, ECONOMIC SURVIVAL IS A SERIOUS QUESTION. TO HELP THIS GROUP, THERE MUST BE A RESTRUCTURING OF FARM DEBT.

MR. CHAIRMAN, WE HAVE HEARD YOU SAY THAT UNLESS SOMETHING CAN BE DONE QUICKLY, A NUMBER OF FARMERS WILL NOT BE ABLE TO GET FUNDS TO LAST TILL NEXT YEAR.

MR. CHAIRMAN, TODAY WE WOULD LIKE TO DISCUSS WITH YOU A PLAN TO RESTRUCTURE FARM DEBT, KNOWN AS THE MODIFIED AGRICULTURAL DEBT RECOVERY ACT OF 1985, H.R. 2064 and S. 719.

THE MODIFIED DEBT RECOVERY ACT IS A PLAN TO BUY TIME. IT IS A PLAN TO MAKE CASH FLOW WORK. IT IS A PLAN TO SHARE RISK.

IT IS A PLAN WHICH CAN BE IMPLEMENTED TODAY.

THE MODIFIED DEBT RECOVERY ACT USES EXISTING RESOURCES. IT TAPS THE EXPERTISE OF PRIVATE LENDERS AND THE LENDING PROGRAMS OF THE FARMERS HOME ADMINISTRATION. BOTH OF THESE RESOURCES ARE ALREADY IN PLACE. WHAT IS NEEDED IS FOR THESE RESOURCES TO BE BROUGHT TOGETHER IN A MODIFIED FORM. THAT IS WHAT THE MODIFIED DEBT RECOVERY ACT ACCOMPLISHES.

MR. CHAIRMAN, RATHER THAN TAKE THE TIME OF THE COMMITTEE TODAY TO DISCUSS THE FIGURES WHICH WE ARE ALL FAMILIAR WITH, ALL OF WHICH POINT TO THE AGRICULTURAL CREDIT CRISIS WHICH WE ALL KNOW THAT OUR FAMILY FARMERS AND RANCHERS FACE, I WOULD LIKE TO GET RIGHT INTO THE HEART OF THE MODIFIED DEBT RECOVERY ACT AND GO THROUGH SOME EXAMPLES TO SHOW HOW IT CAN EFFECTIVELY RESTRUCTURE TROUBLED FARM DEBT.

TODAY THE SITUATION IS CRITICAL FOR OUR FAMILY FARMERS AND RANCHERS. ALL ACROSS AGRICULTURAL AMERICA, THE FARM DEBT PROBLEM HAS BECOME A CRISIS SITUATION.

WE ALL REALIZE THAT PRICE IS THE NUMBER ONE PROBLEM. BUT THE NEED TO RESTRUCTURE TROUBLED FARM DEBT REMAINS A HIGH PRIORITY AND PRINCIPAL NEED IF WE ARE TO KEEP FAMILY FARMERS AND RANCHERS IN BUSINESS.

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE, I WOULD LIKE TO REFER YOU TO THE MODIFIED CREDIT ILLUSTRATIONS BELOW TO DEMONSTRATE WHAT THE PROGRAM CAN DO TO RESTRUCTURE AND INDIVIDUAL'S TROUBLED FARM DEBT. THESE ILLUSTRATIONS ARE FROM PAGE 9 OF THE MODIFIED AGRICULTURAL DEBT RECOVERY PROGRAM WHICH IS ATTACHED IN ITS ENTIRETY TO THIS TESTIMONY.

THE PROGRAM IS MEANT TO BE USED FOR FAMILY FARM AND RANCH OPERATIONS WITH A REASONABLE CHANCE FOR SUCCESS. IT IS MEANT FOR THOSE WHO CAN STILL BET THE FAMILY FUTURE THAT THEIR FUTURE IS WITH FARMING.

THE PROGRAM IS DESIGNED FOR FARM FAMILIES WHO ARE IN FINANCIAL DIFFICULTY, YET WHO CAN BE HELPED WITH THE RIGHT PROGRAM. IT IS TARGETED TO FAMILY FARM AND RANCH OPERATIONS WITH ANNUAL GROSS SALES BETWEEN $40,000 TO $250,000.

IT IS THE ONLY PROGRAM NOW ON THE TABLE THAT CAN COME CLOSE TO SOLVING THE PROBLEM AND HANDLE THE AMOUNT OF DEBT RESTRUCTURING THAT IS NECESSARY. IN ADDITION, MR. CHAIRMAN, IT IS A SOLUTION TO THE TREMENDOUS PROBLEMS THE FARM CREDIT SYSTEM IS PRESENTLY HAVING.

AGAIN, I EMPHASIZE THAT THE RESOURCES ALREADY EXIST TO ACCOMPLISH THIS PROGRAM. THE LOCAL LENDERS ARE ALREADY IN PLACE. THE FARMERS HOME ADMINISTRATION PROGRAMS ARE ALREADY IN PLACE. WHAT IS NEEDED IS TO MODIFY THESE PROGRAMS AND BRING THESE RESOURCES TOGETHER.

Example 1 - Farm Borrower with Commercial Lender
Loan Term - 5 years
Loan Interest Rate - 13 1/2%
Cash Required for:

Principal Reduction	$20,000
Interest Payment	13,500
Total	$33,500
Payment Deficit	$12,500

Example 2 - Farm Borrower under Approved Lenders Program (no modifications)

Loan Term -	7 years	15 years*
Loan Interest Rate - 13 1/2%		
Cash Required for:		
Principal Reduction	$14,285	$ 6,666
Interest Payment	13,500	13,500
Total	$27,785	$ 20,166
Payment Deficit	$ 6,785	-0-

*Only available for self-perpetuating assets (dairy herd, etc.), up to 15-year amortization with 7th year balloon.

Example 3 - Farm Borrower under CA Modified Debt Recovery Program Debt is divided between the Approved Lender Loan and either the Insured Loan (3A) or the Limited Resource Loan Programs (3B)

	Approved Lender Loan (3A)	Approved Lender Loan (3B)
FmHA Guarantee Loan	$50,000	$60,000
Loan Term	7 years	7 years
Loan Interest Rate	10%	10%
Repayment required for:		
Principal Reduction	$ 7,143	$ 8,571
Interest Payment	5,000	6,000
Total	$12,143	$14,571
	Plus Insured Loan	Plus Limited Resource
FmHA Operating Loans	$50,000	$40,000
Loan Term	15 years	15 years
Loan Interest Rate	10 1/4%	7 1/4%
Payment required for:		
Principal Reduction	$ 3,333	2,666
Interest Payment	5,125	2,900
Total	$ 8,458	$ 5,566
Total Payment Required for:		
Principal Reduction	$10,476	$11,237
Interest Payment	10,125	8,900
Total	$20,601	$20,137
Cash Flow Balance	$ 392	$ 863

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE, I WOULD LIKE TO THANK YOU FOR TAKING THE TIME TO GO THROUGH THESE EXAMPLES. I WOULD ESPECIALLY LIKE TO THANK REPRESENTATIVES ARLAN STANGELAND, VIN WEBER, TIM PENNEY, AND TOM DASCHEL FOR BEING SPONSORS OF THE MODIFIED DEBT RECOVERY ACT OF 1985.

I EMPHASIZE THAT THERE ARE MANY FARMERS WHO CAN BE SAVED WITH THE RIGHT DEBT RESTRUCTURING PLAN. THIS LEGISLATION HAS BEEN FORMALLY ENDORSED BY FARM GROUPS, BANKING ORGANIZATIONS, GOVERNORS, AND STATE LEGISLATORS THROUGHOUT THE COUNTRY. I BELIEVE, AS DO THEY, THAT THIS PROGRAM IS THE RIGHT PROGRAM. IT IS THE ONLY PROGRAM NOW ON THE TABLE THAT CAN COME CLOSE TO SOLVING THE PROBLEM AND HANDLE THE AMOUNT OF DEBT RESTRUCTURING THAT IS NECESSARY.

AND IT IS A PROGRAM WHICH CAN BE ACCOMPLISHED TODAY.

MR. CHAIRMAN, THANK YOU FOR THIS OPPORTUNITY TO ONCE AGAIN APPEAR BEFORE THIS SUBCOMMITTEE. THIS IS THE MOST IMPORTANT ISSUE FACING AGRICULTURAL AMERICA TODAY. I WOULD BE HAPPY TO ANSWER ANY QUESTIONS THAT YOU MAY HAVE.

(Attachment follows:)

FARM DEBT RESTRUCTURING

CA MODIFIED DEBT RECOVERY PROGRAM

CA is proposing a farm-debt restructuring plan designed to build on present programs, and target farm borrowers who are in financial difficulty yet who can be helped with the right program. (See page 10, Example 3 for an illustration of CA Modified Debt Recovery Program.)

Today, many farmers find themselves in a financial bind. While about 30% of farmers have little or no debt and are doing well economically, there are between 30% and 40% of all farmers who have substantial debt and are in various stages of financial difficulty.

Who are these farmers in difficulty?

According to recently released figures, approximately two thirds of the nearly 215 billion dollars of farm debt nationally is held by borrowers slipping toward insolvency. In January, 1984, approximately 19 percent of the farmers nationally had debt to asset ratios of over 40 percent. Less than one year later, this figure increased to nearly 29 percent. The deterioration in the farm economy is shown in Table 1.

Table 1. Change in Financial Condition of U.S. Farmers by Debt-to-Asset Ratio, January, 1984 to December, 1984.

	Debt-to-Asset Ratio			
	0-10	11-40	41-70	Over 70
Operators (percent)				
January, 1984	58	24	11	8
December, 1984	41.1	30.2	16.6	12.1

Source: Federal Reserve Bulletin, January, 1984.
Farm Journal Survey, December, 1984.

According to Professor Neal E. Harl of Iowa State University, in testimony presented at a hearing of the House Agricultural Subcommittee on Conservation, Credit and Rural Development on February 7, 1985, 28 percent of the total farmers in Iowa were sliding toward insolvency. Table 2 shows the financial condition of Iowa farmers as of January, 1984 comparing them to December, 1984 figures from the central region of the country.

Table 2. Change in Financial Condition of Iowa Farmers by Debt-to-Asset Ratio, January, 1984 to December, 1984.

	Debt-to-Asset Ratio			
	0-10	11-40	41-70	Over 70
Operators (percent)				
January, 1984	36	35	18	10
December, 1984	31.5	26	21.5	21

Source: Iowa Farm Finance Survey
Farm Journal Survey, December, 1984

According to Professor Harl, "recent data indicate that a sharp movement has occurred to borrowers in the 41-70 percent category and to the over 70 percent group. Moreover, a significant number from 11-40 percent category have moved into the 41-70 percent group."

What is the nature of the farm debt?

Nationally, the total farm debt has increased dramatically. In 1971, total farm debt totalled around $54 billion; in 1976, around $91 Billion; and in 1984, total farm debt stands at $215 billion.

Farmers as a group have a much higher debt to income ratio now than in the past. In 1950, the overall debt-to-income ratio stood as less than 1; in 1960, it doubled to 2, changed to over 3 in the early 1970's, to 8 in 1980 and to 10 in 1984. Today the average farmer is trying to support $10 of debt for every $1 of income.

But even more important, the nature of the debt has changed dramatically. Debt today has a much shorter maturity.

Much of the debt is short term with interest rates tied to current loan rates. Even real estate debt is based on variable interest rates or is based on relatively short contract purchases. Maturities on a great deal of real estate debt has moved from 20-25 years in the 1960's and 1970's to 10-15 years or less today.

Can farmers with heavy debt loads be saved?

For a substantial segment of the 30% to 40% of farmers who have substantial debt and who are in various stages of financial difficulty, economic survival is a serious question. To help this group there must be a restructuring of farm debt. This group, mostly full-time family farmers, were caught with too much debt at the wrong time, debt that was manageable under the prevailing economic conditions when it was incurred but became a crushing burden when conditions changed.

In the group of farmers, there are many good farmers facing bankruptcy for lack of a way to make the transition from an economy of high inflation, raising land values and low interest rates to one of low inflation, sinking land values and high interest rates.

Many of the farmers in this group can be helped and saved with the right debt restructuring programs.

CA's Debt Restructuring Proposal

In order for farm debtors to pay off debt obligations, a major restructuring of indebtedness will be necessary.

The number one feature of any debt restructuring program is to stretch out principal payments into a manageable debt repayment schedule. The second major feature must provide for a lower rate of interest, and third, for farm lending to continue, the risks must be shared.

The CA proposal utilizes existing FmHA programs and expertise of commercial lenders to accomplish this.

These are the Approved Lenders Program, Insured Operating Loan Program and Limited Resource Program. CA's Debt Restructuring Plan modifies slightly these existing FmHA programs to create a program of modified recovery debt credit.

The heart of the CA debt restructuring proposal is the utilization of FmHA's Approved Lender Program, with some minor modifications.

FmHA Approved Lender Program

Under FmHA's Approved Lenders Program, a qualified commercial lender is approved in advance to process FmHA Guaranteed Loans. The approved lender makes the loan, services the loan and collects the loan, thereby reducing the paperwork and time required for FmHA approval of loan guarantees. The lender is responsible for seeing that proper and adequate security is obtained and maintained. FmHA makes the final decision on farmers' eligibility, use of funds, and credit worthiness.

Who does the Approved Lenders Program Help?

In today's farm economy, there are many farmers whose debt-to-assets ratio between 40% and 70% who are caught in a 'credit availability gap.' These farmers are not in serious enough financial difficulty for consideration by the lender of last resort, FmHA. Yet, they do not quite meet the credit standards of private commercial lenders.

This group is a relatively stronger class of farm borrowers than normal FmHA borrowers. The problem for this class of farm borrowers is that their cash flow is inadequate under current high interest rates and low commodity prices, though their basic personal net worth and equity remains relatively strong. The security behind the loan is strong enough to satisfy the bank lender, yet the loan is classified by bank regulators as a classified loan. For the bank, every classified loan reduces the amount of available assets against which credit can be made available, resulting in less credit being available to farm borrowers.

The FmHA Loan Guarantee Program

FmHA Loan Guarantees are designed to provide the credit necessary for family farmers to conduct successful operations. The loans are to be used for the purchase of farm machinery and equipment, basic livestock, annual operating expenses and refinancing for authorized operating loan purposes. Interest rates may be fixed or variable and cannot exceed the rate common in the area. The terms of the loan may be up to seven years on basic security. Quality loans may be guaranteed up to 90% while high risk loans may receive less than a 50% guarantee.

How Will the Approved Lenders Program Help?

Utilizing FmHA's Loan Guarantee Program, the commercial lender will have the additional security to make a bankable loan to farmers who find themselves in a "credit gap". The program is not a bailout for lenders. Unless the loan meets requirements, with a reasonable chance for success FmHA will not approve it.

The program will help, first, by making credit available.

Second, the banker will use the banks own (pre-FmHA approved) loan forms familiar to both the borrower and the banker, reducing FmHA's paper-handling load. Third, credit will be available on a much quicker basis, assuring that available guarantee loan funds reach eligible farmers as quickly as possible. Fourth, the banker and borrower are familiar with each other, helping to insure that better loans will be made. Fifth, the borrower is most likely to stretch out the loan payback. A commercial lender will normally have a maximum of five years on the loan while under the FmHA Loan Guarantee Program, a maximum of seven years is possible. This extra two years can assist the farm borrower in achieving an attainable cash flow-payback program.

CA's Modified Debt Recovery Program

CA proposes to utilize FmHA's Approved Lenders Program and Operating Loan Programs to achieve a significant plan for farm debt restructuring. To achieve this will require some modification of each of these programs.

Modifications to the Approved Lenders & Direct Loan Programs

A basic modification to the Approved Lenders Program is to place a maximum rate to be charged on interest. Under the Approved Lenders Program, interest rates may not exceed the prevailing interest rate in the areas in which the loan is made.

Under the modified Approved Lenders Program, a maximum interest rate would be set at 2 1/2% above discount rate. This would yield an interest rate of 10% at December 31, 1984 rates.

Clearly, there is a need to lower interest rates in order to create a more achievable positive cash flow-debt repayment plan for many farm borrowers. In addition to the obvious advantage of lower interest rates, by lowering the maximum interest rate which a commercial lender may charge under the Approved Lenders Loan Program, the result will be to create opportunities for additional farm borrowers to take advantage of the Loan Guarantee Program. A lower maximum interest rate will encourage the lender to graduate the borrower to a regular commercial status.

The second basic change in the Approved Lenders Program would be to limit the Approved Lenders guarantee to a maximum of 50% whenever the direct lending authorities of the FmHA (Insured Loan Program and Limited Resource Program) are used by a lender to restructure a loan.

FmHA Operating Loan Program

FmHA Operating Loans are made for both operating expenses and farm ownership. Ownership loans may carry an interest rate as low as 5 1/2% and may be written up to 40 years. Operating loans may carry an interest rate as low as 7 1/4% and may be written up to 7 years. Under the Direct Loan Program, appraisals are done by the FmHA and security in the loan is named and itemized per lender.

Modifications to the Direct Loan Program

In order to restructure farm debt, lower interest rates and longer pay back terms will be required to attain a manageable, attainable cash flow for many farm borrowers.

The CA Modified Debt Recovery Program would incorporate into the Approved Lenders Program the use of FmHA Operating Loans in the same manner as the FmHA Guaranteed Loans. The pre-FmHA approved commercial lender would process the paperwork for FmHA Operating Loans, using the commercial lender's forms. FmHA would still have the final say-so on the loan under a shortened turn around approval or denial. Appraisals would be done by the pre-FmHA approved commercial lender or qualified appraiser. The main change in the present FmHA Direct Operating Loan Program would be to share security on a pro-rated dollar value basis. This last change is important to create an environment where the financial risk is shared and one which will create far fewer complications than the present system of named security.

Modified Credit Illustration

Under the CA Modified Debt Recovery Program, there can be a significant debt restructuring which will assist present financially troubled borrowers who have a stronger asset base yet who can neither qualify for FmHA loans or regular commercial lender loans.

As an illustration:

Farm Borrower with $100,000 of indebtedness - cash flow shows $21,000 available for debt retirement.

Example 1 - Farm Borrower with Commercial Lender
Loan Term - 5 years
Loan Interest Rate - 13 1/2%
Cash Required for:

Principal Reduction	$20,000
Interest Payment	13,500
Total	$33,500
Payment Deficit	$12,500

Example 2 - Farm Borrower under Approved Lenders Program (no modifications)

Loan Term -	7 years	15 years*
Loan Interest Rate - 13 1/2%		
Cash Required for:		
Principal Reduction	$14,285	$ 6,666
Interest Payment	13,500	13,500
Total	$27,785	$ 20,166
Payment Deficit	$ 6,785	-0-

*Only available for self-perpetuating assets (dairy herd, etc.), up to 15-year amortization with 7th year balloon.

Example 3 - Farm Borrower under CA Modified Debt Recovery Program
Debt is divided between the Approved Lender Loan and either the Insured Loan (3A) or the Limited Resource Loan Programs (3B)

	Approved Lender Loan (3A)	Approved Lender Loan (3B)
FmHA Guarantee Loan	$50,000	$60,000
Loan Term	7 years	7 years
Loan Interest Rate	10%	10%
Repayment required for:		
Principal Reduction	$ 7,143	$ 8,571
Interest Payment	5,000	6,000
Total	$12,143	$14,571

	Plus Insured Loan	Plus Limited Resource
FmHA Operating Loans	$50,000	$40,000
Loan Term	15 years	15 years
Loan Interest Rate	10 1/4%	7 1/4%
Payment required for:		
Principal Reduction	$ 3,333	2,666
Interest Payment	5,125	2,900
Total	$ 8,458	$ 5,566

Total Payment Required for:		
Principal Reduction	$10,476	$11,237
Interest Payment	10,125	8,900
Total	$20,601	$20,137
Cash Flow Balance	$ 392	$ 863

From the examples, the Modified Debt Recovery Program has accomplished a significant reduction in interest rates and has extended payments over a longer period of time to achieve a reasonable and achievable cash flow.

The Modified Debt Recovery Program covers the three areas of need: restructuring of debt, adjustment of interest and sharing of risk. The Modified Debt Recovery Program shares the risk by bringing the Government in on a maximum of 50% guarantee of the Approved Lender Program. Debt is restructured by adding the direct lending programs and interest is lowered through the direct lending programs to a minimum of 7 1/4% and a maximum of 2 1/2% plus Discount Rate on the Approved Lender portion. The Modified Debt Recovery Program utilizes the assets of the FmHA and adds the expertise of Commercial Lenders.

Prepared by:
Communicating for Agriculture
April 3, 1985

CA MODIFIED DEBT RECOVERY PROGRAM

CREDIT DISK # 32

FARM REAL ESTATE DEBT (January '84) — Shared by Lender:

	1980	1981	1982	1983	1984	1980	1984
	--------Bil Dollars	----------------	----------------	----------------	----------------	----(Pct)	----
FL Banks	29.89	36.29	43.26	47.09	48.12	35.00	43.00
FmHA	6.83	7.64	8.44	8.76	10.07	8.00	9.00
Life Ins	11.96	13.27	12.66	13.14	12.31	14.00	11.00
Comm'l	8.54	8.6	8.44	8.76	8.95	10.00	8.00
Ind & Oth	28.18	30.56	31.65	31.76	32.45	33.00	29.00
Total	85.4	96.36	104.45	109.51	111.9	100.00	100.00

FARM NON-REAL ESTATE DEBT (January '84)

	1980	1981	1982	1983	1984	1980	1984
PCA	17.69	19.87	21.14	20.27	18.58	22.01	18.22
FmHA	8.84	12.1	14.42	14.94	15.48	11.00	15.18
F I C B	.8	.86	.96	.85	.82	1.00	0.80
Comm'l	31.36	31.97	32.67	36.28	36.18	39.01	37.45
Ind & Oth	16.88	18.14	19.22	19.21	18.58	21.00	18.22
CCC	4.82	5.18	7.69	14.94	10.32	6.00	10.12
Total	80.39	88.12	96.1	106.96	101.96	100.00	100.00
TOTAL	165.79	184.48	200.55	216	213.86		

Average D/A ratio, by sales Class:
(Jan 1, 1984)

10-20	15.7
20-40	15.9
40-100	19.4
100-200	21.5
200-500	27
>500	36.6

ANALYSIS:

NON-RE TOTAL	101.96
FmHA	15.48
CCC	10.32
Non-Com'l	18.58
Bal	57.58
Excl high risk	23.03
Excl part time	5.00
Bal Full time	29.548

Est full time, in
trouble with
40-70 pct d/a ratio
2.9548 bil dlrs

CA Program
Restructure $2,954 billion in current debt

Two Programs:	A	B	Total	
Amount:	-----million	dollars	-------	
Guarantee Approved Lender	590.96	739.70	1329.66	Much of the credit would be available government subsidized interest.
Interest Subsidy	0	0	0	
Administrative cost	41.3672	51.709	93.0762	
Total	41.3672	51.709	93.0762	
FmHA OL				
Limited Resource	0	738.70	738.70	Subsidies would be required for 55 percent of the credit under plan.
Insured	886.44	0	886.44	
Subsidy, CCC at 10,5	16.62	180.06	196.68	
Administrative cost	132.97	110.81	243.77	
Total	149.59	290.86	440.45	
Total Credit	1477.40	1477.40	2954.80	
Total Govt Cost	190.95	342.57	533.53	
Annual Govt Cost	15.88	26.78	42.66	

February 12, 1985

THE FARM CREDIT SYSTEM PLAYS A VERY IMPORTANT ROLE IN THE OVERALL VIABILITY OF NOT ONLY THE AGRICULTURAL SECTOR, BUT ALSO IMPACTS AS WELL ON THE NATIONAL ECONOMY. IT IS IMPERATIVE THAT AGRICULTURE BE SUSTAINED BY A STRONG CREDIT POSITION ON THE PART OF FARM LENDING INSTITUTIONS. IT IS MY PERSONAL OPINION THAT UNLESS THE FARM CREDIT SYSTEM RECEIVES AN INFUSION OF CAPITAL WITHIN THE NEXT SIXTY DAYS; THE FARMERS WHO ARE SOLVENT TODAY WILL NOT BE SOLVENT TOMORROW.

AT THIS TIME, INTEREST RATES FOR FARM CREDIT IN THE MIDWEST ARE RUNNING 5 TO 7 PERCENT ABOVE THE PRIME RATE. EVERYBODY BORROWING MONEY TODAY IS PAYING A LOWER RATE OF INTEREST...EXCEPT THE FARMER. FOR EXAMPLE, FARMERS BORROWING FROM THE PRODUCTION CREDIT ADMINISTRATION IN MY STATE ARE PAYING ANYWHERE FROM 13.56 TO 15.89 PERCENT, WHICH INCLUDES STOCK. AND IN THE SAME VEIN, FARMERS BORROWING FROM THE FEDERAL LAND BANK ARE PAYING AN INTEREST RATE OF 13.2 PERCENT. WITH FARM COMMODITY PRICE LEVELS BEING WHAT THEY ARE TODAY, COUPLED WITH PRICE PROJECTIONS FOR THE REST OF THE YEAR AND INTO 1986, THERE IS ABSOLUTELY NO WAY A FARMER HAVING THESE KINDS OF HEAVY INTEREST LOADS CAN REMAIN SOLVENT.

IT IS REALLY A PARADOXICAL SITUATION IN THAT OUR FARM CREDIT SYSTEM, WHICH IS DESIGNED TO ASSIST FARMERS IN THE PRODUCTION OF FOOD AND FIBRE FOR THIS COUNTRY, COULD TURN OUT TO BE THE INSTRUMENT WHICH SELF-DESTRUCTS THESE VERY SAME PRODUCERS.

WE HAVE TO CONCLUDE THAT THE FARM CREDIT SYSTEM CANNOT HELP ITSELF INTERNALLY AT THIS TIME. FOR EXAMPLE, A FREEZE ON PCA STOCK WOULD BE DISASTROUS, NOT ONLY TO THE BORROWING FARMERS, BUT WOULD ULTIMATELY FORCE AGRICULTURE INTO BORROWING FROM OTHER SOURCES...IF SUCH SOURCES COULD BE FOUND. IT IS OUR UNDERSTANDING THAT COMMERCIAL BANKS TODAY HAVE AMPLE SUPPLIES OF CASH, BUT ABSOLUTELY NO INTEREST WHATSOEVER IN DEVELOPING AGRICULTURAL PORTFOLIOS. THE BOTTOM LINE IS THAT AGRICULTURE IN TOTAL IS IN SUCH A FINANCIAL DISARRAY AND FILLED WITH SO MUCH UNCERTAINTY, THAT THE MAJORITY OF COMMERCIAL BANKS HAVE NO INTEREST IN MAKING AGRICULTURAL LOANS.

LET ME GIVE YOU AN EXAMPLE OF WHAT IS HAPPENING TODAY IN MINNESOTA AS FAR AS AGRICULTURAL RELATED BANKING IS CONCERNED. THE FIRST BANK SYSTEM IN OUR STATE JUST RECENTLY ANNOUNCED THE OFFERING FOR SALE OF TWENTY-EIGHT BANKS WITHIN THEIR SYSTEM. IN THE TRUE SENSE OF THE WORD, THIS IS A REFLECTION OF A NEGATIVE ATTITUDE BY THE SYSTEM ON THE ABILITY OF AGRICULTURE TO REPAY LOANS. THERE IS NO QUESTION IN OUR MIND, THAT ONCE THESE BANKS ARE SOLD, THEY WILL NO LONGER BE INTERESTED IN MAKING LOANS TO FARMERS. WHAT THIS REALLY MEANS IS THAT THESE CREDIT SOURCES FOR FARMERS WILL DRY-UP. SUCH A DEVELOPMENT PLACES EVEN GREATER IMPORTANCE ON MAINTAINING A STRONG FARM CREDIT SYSTEM AS WE HAVE KNOWN IT IN THE PAST. OTHERWISE, WHERE DO AGRICULTURAL PRODUCERS TURN FOR CREDIT?

IT IS OUR REASONING THAT THE FARM CREDIT CRUNCH BEING EXPERIENCED NOW IS NOT NECESSARILY THE FAULT OF THE FARM CREDIT SYSTEM. IT'S A COMBINATION OF CIRCUMSTANCES BEGINNING OVER A DECADE AGO WHEN FARMERS WERE ENCOURAGED BY OUR GOVERNMENT TO GEAR-UP CROP PRODUCTION TO FULL POTENTIALS...THAT THERE WOULD BE A WORLD SHORTAGE OF FOOD BY THE 1980'S...AND THE EXPORT MARKET FOR GRAINS WOULD CONTINUE TO EXPAND. AND OUR AGRICULTURAL LENDING AGENCIES WERE CAUGHT UP IN THE SAME FERVOR. HOWEVER, ALL THESE WONDERFUL PROJECTIONS FAILED TO MATERIALIZE WITH THE END RESULT OF LOWER AND LOWER FARM COMMODITY PRICES AND GREATER AND GREATER DEBT LOADS ON FARMERS. CONSEQUENTLY, LET'S NOT PUT ALL THE BLAME ON OUR FARM LENDING INSTITUTIONS. IT IS MY FIRM CONVICTION THERE IS NOT A CREDIT INSTITUTION IN THIS COUNTRY THAT COULD WITHSTAND A FIFTY PERCENT REDUCTION IN ASSETS OVER THE PAST SEVERAL YEARS AND REMAIN SOLVENT.

IT APPEARS TO ME THE CREDIT CRISIS IN AGRICULTURE TODAY IS THE END RESULT OF SEVERAL FACTORS NOT NECESSARILY RELATED TO THE LENDING PRACTICES OF OUR FARM CREDIT SYSTEM. WE WOULD SUGGEST THAT THE FOLLOWING SITUATIONS AND DEVELOPMENTS HAVE PLACED FARMERS AND OUR LENDING INSTITUTIONS IN TODAY'S PRECARIOUS POSITION...(1) THE GRAIN EMBARGO OF SEVERAL YEARS AGO; (2) OUR CURRENT BUDGET DEFICIT; (3) THE STRONG U.S. DOLLAR AND (4) THE UNFAIR AND SUBSIDIZED TRADE PRACTICES OF FOREIGN GOVERNMENTS IN THIRD WORLD MARKETS.

NEVERTHELESS, IT IS IMPERATIVE THAT THE FEDERAL GOVERNMENT UTILIZE EVERY RESOURCE AVAILABLE TO SHORE-UP THE FARM CREDIT SYSTEM AND IN A MANNER THAT LOANS TO FARMERS WILL BE AT COMPETITIVE RATES OF INTERST. OTHERWISE, BANKRUPTCIES IN AGRICULTURE WILL INCREASE IN GEOMETRIC PROPORTIONS. THIS IN TURN, WILL TRIGGER A NEGATIVE DOMINO EFFECT INVOLVING MANY BUSINESSES, BOTH LARGE AND SMALL, WHO PROVIDE GOODS AND SERVICES TO FARMERS, NOT TO MENTION THE NEGATIVE EFFECT SUCH A SCENARIO WILL HAVE ON OUR NATIONAL ECONOMY.

IN CONCLUSION, MR. CHAIRMAN, THE FINANCIAL STABILITY OF OUR NATION'S FOOD PRODUCERS IS AT A CROSSROAD. ALSO AT A CROSSROAD IS THE INTEREST OF THE AMERICAN CONSUMER AS RELATED TO A CONTINUING SUPPLY OF FOOD AT A REASONABLE COST.

THANK YOU FOR THE OPPORTUNITY OF APPEARING HERE TODAY. WE WILL BE PLEASED TO ANSWER ANY QUESTIONS YOU OR MEMBERS OF THE COMMITTEE MAY HAVE.

NCA
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Testimony on Behalf

of the

NATIONAL CATTLEMEN'S ASSOCIATION

on
"The Agricultural Credit Crisis"

before
The Honorable Ed Jones, Chairman
Conservation, Credit and Rural Development Subcommittee

submitted by

Jo Ann Smith, President
National Cattlemen's Association

accompanied by
John W. Ross, NCA Director
for Tax, Finance and Agricultural Policy

September 11, 1985

The National Cattlemen's Association is the national spokesman for all segments of the nation's beef cattle industry--including cattle breeders, producers, and feeders. The NCA represents approximately 200,000 professional cattlemen throughout the country. Membership includes individual members as well as 51 affiliated state cattle associations and 18 affiliated national breed organizations.

Mr. Chairman and members of the Subcommittee, I want to thank you for this opportunity to testify on agricultural credit issues. I am Jo Ann Smith, and President of the National Cattlemen's Association. On behalf of the NCA, let me commend you for holding this hearing.

Mr. Chairman, you know the statistics of the agricultural credit crisis. Others are presenting information on how agriculture in general is affected. Without question, all of agriculture is hurting.

Let me focus on how the cattle industry is affected:

--We do not know how many ranchers and cattle feeders have been forced out of business due to financial problems, but we do know that the beef cowherd has declined by 3.8 million head since 1982, a reduction of ten percent. Further, cattle feeding in several key states has declined by as much as thirty percent since 1980.

--Our analysts estimate that the cattle industry as a whole has lost over $1 billion since January 1, 1985.

--Some of our problems over the last five years have been either caused or compounded by attempts to solve problems in other sectors of agriculture. Obviously, part of our problem is due to generally poor economic conditions throughout agriculture. Another part is due to changes in consumer demand.

We are addressing the consumer demand question, but the credit issue and economic conditions in agriculture must be addressed by Congress. The Congress must recognize the critical financial state of agriculture, and must take steps to address the problems.

There is no single answer, nor any easy answers. Agriculture is facing a massive restructuring. As we go through that restructuring, losses are a certainty. Further, agriculture is suffering from interest rates that are five or six points above the prime interest rate.

Congress must focus on two issues: (1) measures that will reduce interest rates to agricultural producers, and, (2) measures that will assist agricultural producers and lenders to absorb losses that must be taken, while minimizing disruptions to agriculture. Some farmers and ranchers will inevitably go out of business; unfortunately, that is a fact of agriculture.

The answer will not come from helping just the Farm Credit System or commercial lenders. A number of alternatives must be considered, and a credit package must be developed. This package may include provisions that must be reviewed by other committees, but the leadership must come from the Agriculture Committee.

Among all the ideas that will be proposed, we urge you to consider the following:

1) Along with restructuring and increasing the Farm Credit System, regulatory enforcement of Congress may need to provide an infusion of capital to maintain the viability of the System,

2) Increased funding for Farmers Home Administration programs, particularly for loan guarantees, but also for direct loans and interest rate buy-downs. At the same time, Congress must mandate that Farmers Home sell or otherwise dispose of that part of their loan portfolio that is not recoverable. Farmers Home funds must be used to help the individuals who, with some assistance, can cash flow and survive.

3) Stretching out the time allowed for commercial banks to write off loans, and,

4) Changing the Alternative Minimum Tax law to remove an unfair tax burden presently imposed on insolvent farmers, as well as changing the tax treatment of loan charge-offs so farmers will not have to pay taxes on these charge-offs.

I am attaching an article that outlines other alternatives to be considered in addressing the credit situation. Let me again commend you for recognizing the seriousness of this credit crisis. You do not have an easy task before you.

However, we want to work with you, the other agricultural organizations, and the agricultural lenders, to develop programs and policies on agricultural credit. We must work together to relieve the tremendous financial burden that is suffocating U.S. agriculture.

(Attachment follows:)

Resolving the Ag Credit Crisis

by John Ross, Director of Tax and Finance, NCA

USDA and the Food and Agricultural Policy Research Institute estimate that nearly $50 billion of the $210 billion in agricultural debt won't be serviced in 1985 or 1986 at present and projected farm income levels. In addition, loan losses may reach $25 billion in 1986-1988.

The credit crisis is concentrated in large, commercial operations with gross sales over $100,000. Thirty percent of the nation's farmers and ranchers hold over 60 percent of all agricultural debt, or $140 billion of the $210 billion total. Loan losses in this group could severely impact other producers and the agricultural credit institutions. A few conclusions can be drawn from the current situation:

(1) The problem is large, effects the most productive farmers and isn't limited to a specific commodity.

(2) It can't be addressed solely through the Farm Bill, although the Farm Bill is part of the solution.

(3) Several legislative and regulatory changes must be considered.

(4) The cost of solutions to the ag credit problem must be balanced against the cost of the federal deficit.

However, all approaches combined aren't going to eliminate loan losses. Further, there isn't one single best approach, and there are no easy answers. This crisis will have to be addressed on several fronts.

The biggest problem is absorbing the losses that must be taken. Taxpayers will take some of the losses primarily through FmHA, but not the biggest share. The credit institutions—commercial banks, the Farm Credit System, trade creditors, insurance companies and other creditors—will also bear some of the loss. Borrowers will bear another share through direct losses and through higher interest rates and reduced credit services. This leaves two questions:

- What measures, if any, will assist producers who must go out of business, or, have equity and may survive if they restructure and/or reduce debt?
- What measures, if any, will maintain the viability of ag lenders,if they must be assisted through a period of losses?

Possible Solutions

The following solutions to the credit crises may be considered this fall by the industry and Congress.

(1) Address the Farm Credit System's liquidity problem through a long term loan from the government to recapitalize the system. These funds could be used to target districts with liquidity problems.

(2) Continue efforts, with local support,to improve the efficiency in the Farm Credit System through restructuring.

(3) Increase FmHA's budget authority for loan guarantees which offers borrowers and lenders time and margin to restructure debt. Also, maintain FmHA direct lending, at least for beginning farmer programs.

(4) Sell part or all of the FmHA portfolio, even at a discount, in order to remove debt that's clearly a deadweight loss from the FmHA portfolio.

(5) Combine a partial interest rate buy-down with an FmHA loan guarantee for borrowers who could cash flow with the buy-down.

(6) Commercial bank regulators should be required to recognize equity and character, in addition to cash flow, as factors affecting loan quality.

(7) Banking regulations could be changed to allow commercial banks a longer period to write off loan losses. They currently have five years.

(8) Funding for Small Business Administration (SBA) guarantees and/or direct loans might be increased to assist trade creditors and agribusinesses in severely affected areas.

(9) Some FmHA funds (guarantees and direct loans) might be targeted at agricultural loans held by insurance companies and individuals.

(10) President Reagan's "enterprise zone" idea might be used by rural communities to attract new businesses.

(11) Several legislative and regulatory changes must be considered to assist borrowers. For example, tax laws that impose a tax on insolvent farmers or laws that restrict the agricultural asset market might be changed. Another set of changes could include direct assistance, such as financial counseling and partial interest rate buy-downs.

(12) An Agricultural Conservation Corporation or "Aggie May", might be created as a quasi-governmental entity to purchase land from lenders and borrowers and hold it off the market.

(13) Some have argued that that the problem can be resolved in the Farm Bill through increased funding for commodity programs. The Farm Bill is important to maintain present income levels and forestall further deterioration. However, the best farm program does little more than hold net farm income at present levels of $20-25 billion. Farm programs only directly affect 35-40 percent of gross ag income and they do little for "non-program commodities."

NCA and other ag organizations believe a "piecemeal" approach to resolving the ag credit crisis shouldn't be adopted. Action to resolve the credit crisis must be coordinated. The industry can't afford a "banker bailout" or an "FmHA borrower bailout." The answer lies in helping all parties involved absorb losses and work their way through the problem.

You should contact your bank directors, district Farm Credit directors and Congressmen and voice your opinion on the ag credit issue. If farmers and ranchers don't speak up, they may find a "solution" imposed upon them.

STATEMENT OF CONGRESSMAN JIM SLATTERY BEFORE THE HOUSE AGRICULTURE SUBCOMMITTEE ON CONSERVATION, CREDIT, AND RURAL DEVELOPMENT REGARDING CURRENT AGRICULTURAL CREDIT CONDITIONS

THANK YOU CHAIRMAN JONES FOR THIS OPPORTUNITY TO ADDRESS THE SUBCOMMITTEE ON CONSERVATION, CREDIT, AND RURAL DEVELOPMENT.

DURING THE AUGUST DISTRICT WORK PERIOD, I HAD THE OPPORTUNITY TO DISCUSS IN DETAIL VARIOUS ASPECTS OF THE AGRICULTURAL CREDIT ISSUE WITH REPRESENTATIVES OF THE AGRICULTURAL CREDIT SYSTEM. IN A TWO AND ONE-HALF HOUR MEETING, I MET WITH FARMERS AND REPRESENTATIVES OF THE KANSAS BANKERS ASSOCIATION, THE FEDERAL DEPOSIT INSURANCE CORPORATION, THE FARM CREDIT SYSTEM WICHITA DISTRICT OFFICE, THE KANSAS BANK COMMISSION, FARMERS HOME ADMINISTRATION, THE FEDERAL RESERVE BANK OF KANSAS CITY, INVESTMENT BANKING SPECIALISTS, AND AGRICULTURAL BANKERS.

IT BECAME OBVIOUS THAT THE DIMENSIONS OF THE AGRICULTURAL CREDIT CRISIS ARE STAGGERING. IT WAS THE CONSENSUS OF THE GROUP THAT ANYWHERE FROM $36 BILLION TO $51 BILLION IN UNSERVICEABLE AGRICULTURAL CREDIT EXISTED NATIONWIDE. THIS APPEARS TO BE SUBSTANTIATED WITH THE RESULTS OF A STUDY BY THE FOOD AND AGRICULTURAL POLICY RESEARCH INSTITUTE OF THE UNIVERSITY OF MISSOURI THAT INDICATES ABOUT 27 PERCENT OF FARM DEBT IS HELD BY 14 PERCENT OF FARM OPERATORS WITH DEBT TO ASSET RATIOS OF OVER 70 PERCENT. THIS IS DEBT THAT WILL PROBABLY NEVER BE REPAID.

FOR KANSAS, THE CRISIS CAN BE PUT IN DIFFERENT TERMS OTHER THAN DOLLARS. IT HAS MEANT THAT DURING THE PERIOD OF JANUARY TO JUNE, 1985, 319 CALLS FOR FORECLOSURES STATEWIDE BY THE FEDERAL LAND BANK ALONE. OF COURSE, MANY OF THESE CASES MAY FIND RESTRUCTURING OR OTHER MONEY MANAGEMENT EFFORTS TO AVOID THE FORECLOSURE, BUT THE RATE IS STILL SIGNIFICANTLY HIGHER THAN THAT EXPERIENCED IN RECENT TIMES. WE HAVE SEEN ELEVEN BANK CLOSURES, THREE-FORTHS OF THEM AGRICULTURAL-RELATED. ONE OF THE BANK CLOSINGS WAS IN MY DISTRICT. THE NUMBER OF FARMERS FACING LIQUIDATION, BY DIRECT FORECLOSURE OR BY JUST GIVING UP, IS INCREASING EVERYDAY. EACH CASE IS STILL AS ALARMING AS THE FIRST TIME WE HEARD IT. TO CALL

THE COMING MONTHS A "WINTER OF DISCONTENT" WOULD BE AN UNDERSTATEMENT OF THE GREATEST DIMENSION.

I AM CONVINCED THE FARM CREDIT SYSTEM WILL NEED FEDERAL ASSISTANCE IF IT IS TO SURVIVE IN THE LONG RUN. EVEN THOUGH THE SYSTEM HAS RESPONDED WITH A POOLING OF FUNDS, IT IS STILL VULNERABLE TO A LIQUIDITY PINCH AND SHOULD BE WORRIED ABOUT ITS CAPITAL STRUCTURE. THUS IF LARGE LOAN LOSSES OCCUR IN A SHORT PERIOD OF TIME, SO THAT THEY CANNOT BE COVERED BY CURRENT EARNINGS, THE CAPITAL WOULD BE DEPLETED RAPIDLY.

ACCORDING TO MEDIA REPORTS AND A BRIEF REVIEW OF FCS FINANCIAL STATEMENTS BY MY STAFF, THE ENTIRE FARM CREDIT SYSTEM HAS ABOUT $11.8 BILLION OF CAPITAL, BUT ONLY $6.8 BILLION IS CONSIDERED PRIMARY CAPITAL. THE REST INCLUDES B STOCK PURCHASES REQUIRED OF BORROWERS AND OTHER TYPES OF CAPITAL THAT ARE CONSIDERED LESS STABLE BECAUSE THEY CAN BE PULLED OUT AT THE FARMER'S INITIATIVE. AS OF MARCH 31, THE SYSTEM'S MOST LIQUID ASSET WAS $3.4 BILLION IN SECURITIES.

THIS LEVEL OF LIMITED LIQUID ASSETS EXISTS AT A TIME WHEN FCS REPORTED IN 1984 THAT FEDERAL LAND BANKS HAD $4.0 BILLION IN TOTAL NONPERFORMING LOANS. THIS $4.0 BILLION FIGURE INCLUDED $2.9 BILLION IN OTHER NONPERFORMING LOANS PLUS $1.1 BILLION NONACCRUAL LOANS.

UNDER THE FCS CLASSIFICATION SYSTEM, OTHER NONPERFORMING LOANS ARE ONES THAT HAVE BEEN PAST DUE 90 DAYS OR MORE, WHERE EXCEPTIONAL CONCESSIONS HAVE BEEN MADE TO BORROWERS FOR LEGAL OR ECONOMIC REASONS, OR WITH SEVERE CREDIT WEAKNESSES. NONACCRUAL LOANS ARE THOSE IN WHICH INTEREST HAS BEEN SUSPENDED BECAUSE COLLECTION OF OUTSTANDING BALANCE IS IN DOUBT, FULL COLLECTION OF FURTHER ACCRUALS OF INTEREST IS IN DOUBT, OR PRINCIPAL AND INTEREST PAYMENTS ARE IN DEFAULT.

IN 1984, PRODUCTION CREDIT ASSOCIATIONS REPORTED $2.4 BILLION IN TOTAL NONPERFORMING LOANS. THIS INCLUDED $1.7 BILLION OTHER NONPERFORMING LOANS PLUS $637.0 MILLION NONACCRUAL LOANS.

WHEN COMPARED TO THE $3.4 BILLION OF MOST LIQUID ASSETS OF THE FCS, THE $2.1 BILLION OF NONACCURAL LOANS DEMONSTRATES THE DIMENSIONS OF THE LIQUIDITY PINCH THE SYSTEM FACES. WE MUST ALSO KEEP IN MIND THAT A

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PORTION OF THE $7.3 BILLION OF OTHER NONPERFORMING LOANS WILL SLIP INTO THE NONACCRUAL CATEGORY.

HOWEVER, THE EXPERIENCE OF THE FLB IN THE WICHITA DISTRICT PROBABLY DEMOSTRATES THE ACCELERATION IN FLB LOSSES THAT CAN BE EXPECTED OVER THE NEXT TWO YEARS. THE PERCENTAGE OF FLB VOLUME IN NONPERFORMING LOANS FOR THE WICHITA DISTRICT STANDS AT 10.8%, AMONG THE HIGHEST IN THE NATION. THIS FIGURE DOES NOT REFLECT THE TRUE CONDITION OF THE PORTFOLIO WHEN YOU CONSIDER THAT ACCORDING TO WICHITA DISTRICT OFFICIALS NEARLY 23% OF ALL PCA AND FLB LOANS IN THAT DISTRICT HAVE BEEN RESTRUCTURED IN THE LAST YEAR.

THIS ENVIRONMENT POINTS TO THE NEED FOR CONGRESS TO ADDRESS SEVERAL ISSUES DURING THE COMING MONTHS;

1. FIRST, WE HAVE GOT TO CHANGE THE CURRENT MACROECONOMIC POLICY, WHICH IS AT WAR WITH THE INTEREST OF OUR FARMERS, AND THE NATIONAL ECONOMY.

TO CREDIBLY ADDRESS OUR FARM PROBLEM, AND OUR TRADE PROBLEM, WE MUST DEAL --- HONESTLY AND COURAGEOUSLY --- WITH THE FEDERAL BUDGET DEFICIT.

BY DOING SO --- AND ONLY BY DOING SO, CAN WE GET INTEREST RATES DOWN.

AND TO STRENGTHEN THE FARM ECOMONY, WE MUST RESTORE SANITY AND STABILITY TO EXCHANGE RATES. THE OVERVALUED DOLLAR IS A CHAIN AROUND THE NECK OF AMERICA'S FARMERS, AS WELL AS EVERY OTHER IMPORT AND EXPORT SENSITIVE INDUSTRY.

THERE ARE TWO ACTIONS WE CAN TAKE TO LOWER THE VALUE OF THE DOLLAR. FIRST --- AND AGAIN --- WE MUST REDUCE THOS DEFICITS AND ADOPT REALISTIC FISCAL POLICIES. AND SECOND --- WE MUST CONVINCE THE ADMINISTRATION TO COUPLE DIFICIT REDUCTION WITH A CAREFUL, MODERATE PROGRAM OF INTERVENTION IN THE EXCHANGE RATE SYSTEM.

SO, MR. CHAIRMAN, I WOULD EMPHASIZE THE NEED TO CHANGE OUR BROAD ECONOMIC POLICIES --- TO LOWER INTEREST RATES, TO LOWER THE VALUE OF THE DOLLAR --- TO STRENGTHEN OUR DOMESTIC ECONOMY AND RESTORE OUR POSITION OF STRENGTH IN THE INTERNATIONAL MARKETPLACE.

IT IS WITH THIS BELIEF THAT I HAVE DILIGENTLY PURSUED DEFICIT REDUCTION EFFORTS DURING MY THREE YEARS AS A MEMBER OF CONGRESS. IT IS

ALSO WHY I WAS WILLING TO PROPOSE WHAT SOME VIEWED AS A RADICAL BUDGET REDUCTION PACKAGE ON THE FLOOR OF THE HOUSE EARLIER THIS YEAR THAT INCREASED REVENUES AND FROZE ENTITLEMENT PAYMENTS FOR ONE YEAR TO ALL BUT THOSE MOST IN NEED. THIS PROPOSAL WOULD HAVE RESULTED IN A BALANCED BUDGET BY 1989.

2. A COMPREHENSIVE PLAN FOR ASSURING THE AVAILABILITY OF AGRICULTURAL CREDIT MUST BE ADDRESSED. I CALL UPON THE FCS TASK FORCE TO SUBMIT ITS RECOMMENDATIONS TO CONGRESS AS SOON AS POSSIBLE FOR OUR REVIEW. HOWEVER, WE MUST GUARD AGAINST THIS EFFORT BECOMING A BAILOUT FOR WALL STREET INVESTORS IN THE NAME OF ASSISTING FAMILY FARMERS.

I WOULD OBSERVE THAT THE FINANCIAL STABILITY OF THE $75 BILLION FARM CREDIT SYSTEM IS FAR MORE IMPORTANT TO OUR NATION AND OUR FINANCIAL INSTITUTIONS THAN CHYSLER, LOCKHEED, PENN CENTRAL AND CONTINENTAL OF ILLINOIS.

3. WE MUST NOT ALLOW THE WHOLESALE TRANSFER OF LAND THAT COMES INTO THE HOLDINGS OF FDIC, FCS, AND FMHA TO NON-AGRICULTURAL HANDS. FARM FAMILIES THAT PREVIOUSLY OWNED THE LAND MUST BE PROVIDED THE OPPORTUNITY TO RENT OF REPURCHASE SUCH PROPERTIES.

4. THE VARIOUS AGENCIES AND REPRESENTATIVES OF THE AGRICULTURAL CREDIT SYSTEM MUST DO A BETTER JOB OF WORKING TOGETHER TO UTILIZE LIMITED RESOURCES. FCS MUST BE TALKING TO FMHA; FDIC MUST BE TALKING TO BOTH THE PRIVATE SECTOR AND OTHER FEDERAL AGENCIES.

5. CREDIT ASSISTANCE MUST BE EXTENDED TO RESTRUCTURING REAL ESTATE DEBT, IN ADDITION TO NON-REAL ESTATE DEBT. FARMERS, LENDERS, AND RURAL COMMUNITIES WOULD BENEFIT FROM PROGRAMS THAT PREVENT LARGE AMOUNTS OF FARMLAND ON THE MARKET, THUS DEPRESSING LAND VALUES FAR BELOW THEIR ECONOMIC WORTH.

6. THE COMMODITY CREDIT CORPORATION IS ANOTHER SOURCE OF FARM CREDIT. I WOULD ENCOURAGE THE FULL AGRICULTURE COMMITTEE TO PRESERVE AN ANNUAL LIMIT ON NONRECOURSE LOANS, SUFFICIENT TO PRESERVE FARM INCOME, WITH ONLY RECOURSE LOANS AVAILABLE ABOVE THAT LIMIT, RATHER THAN A VERY

LOW CAP ON LOAN PAYMENTS. SUCH A NONRECOURSE LOAN CAP SERVES TO DIRECT LOAN BENEFITS TO TRUE FAMILY FARMERS.

7. WE MUST RECOGNIZE THAT IT WILL BE VERY DIFFICULT FOR THE 90,000 TO 100,000 FARMERS WITH DEBT-TO-ASSET RATIOS OF MORE THAN 70 PERCENT TO CONTINUE FARMING. IN ORDER TO EASE THE ADJUSTMENT OF THESE DISPLACED FARMERS INTO A NEW VOCATION, A COMPREHENSIVE PROGRAM OF RETRAINING AND RELOCATION BENEFITS MUST BE A PART OF THE PACKAGE OF LEGISLATION DEVELOPED BY CONGRESS TO ADDRESS THE CREDIT CRISIS. REFINEMENT OF FMHA RURAL DEVELOPMENT ACTIVITIES TO PROVIDE THE ADDITONAL EMPLOYMENT OPPORTUNITIES MUST ALSO BE ADDRESSED.

THANK YOU, MR. CHAIRMAN, FOR THIS OPPORTUNITY TO ADDRESS AN ISSUE OF UPTMOST IMPORTANCE TO MY DISTRICT AND OUR COUNTY.

STATEMENT OF ROBERT M. HENDRIX, SR. - DYERSBURG, TENNESSEE

I am Robert M. Hendrix, Sr. I have been a farmer all of my life. I have served on the local Production Credit Board of Directions for twenty-four years and presently am Chairman of the Board. I have served on the National Advisory Committee representing Production Credit Associations throughout the United States for about ten years. I was Chairman of that committee for three years during the 1981 legislative effort. Also, I have served on the Louisville Farm Credit Bank Board for six years as District Director. I have served on the Board of Directors for the Farm Bank Governing Body in Denver, Colorado. I am here today representing a grassroots farmer who believes that agriculture, as far as being a profitable venture, is at the crossroads.

During my time in serving on the local Production Credit Board, I have seen an association grow from $13 million to a peak of $127 million in 1981. During this time, the association loaned $1,229,920,754 and only suffered $382,000 in losses. From the year 1981 on, when farm economy began to falter, the associations in our area have suffered substantial losses; but I do not believe that this is because of bad or poor credit administration, but because of poor prices for farm products.

Many of the loans that we have seen today that have become problem loans showed, at the time they were made, that there was profit margin and that they would pay themselves out as they had always done. But due to the farm prices that our members were getting for their products, there was no way that a person could pay the high interest rate and high input cost and have a profitable operation. I know that examples can be pointed out where through conservatism or other methods, some people have held their operations together through these times--and some of them even shown a profit. But I am talking about the average member-borrower that we have in our association that has been put into predicaments through no fault of his own that can no longer cash flow a farming operation. We have had many, many young farmers, who were just getting started in farming, who have had to sell out because they could just not make a living under present conditions. The average

age of farmers today is about fifty-four, because young farmers educated in the field of agriculture have left the farm and will probably never be able to return. The prices of commodities and the price of land have caused other members to have forced-sales. This has brought the price of land down until it will not pay the interest and other upkeep costs.

Considering all of these things, we do not see much hope for the future of farming. I believe that the thing that has made the Farm Credit system so great and profitable for farmers is having grassroots input into the operation of the association and farmers' feeling that they are owners of the system and proud of their organization. Recent news media articles indicate that local boards of directors who are elected by grassroots members that own the system are a hindrance to the system. I think a good parallel of this would be members of Congress who never paid any attention to the people who elect them. This would be like letting the president run the whole show without a Congress; and gentlemen, we know this is not the way a true democracy or a co-operative works. Gentlemen, I ask you, where would this country be without you?

I believe the thing that has made America great is the right of individuals to think and plan for themselves. We find ourselves in a situation today where the associations are being asked to put all their capital into a consolidated structure. This is capital that has been generated for use by the membership, and it belongs to them. If this capital is pooled for the one association, we're told that this equity can never be returned to the members. I believe that there should be some way--when and if this situation turns around--that we would be able to bring that capital back into the association where it belongs.

Co-operatives, as far as the local board of directors, lose complete control of an association or representation of its membership on a board of directors when things like this happen. I know that we live in a changing world today and I know that the methods of financing agriculture must change also, but I have to think that when an individual farmer becomes a number in a computer and the computer decides whether he is worthy of credit, we have lost what we are about. Many examples have been shown that some associations were lax in extending credit. But I think if you look at the commercial banks who have been dealing in agriculture, you will see that if this be true in the Farm Credit system, it certainly is true in the commercial banking system. And their rules, according to recent articles, are much stricter in administering credit than ours. Yet until 1981, they showed a much greater loss from amount of dollars loaned than the Farm Credit system: 2 1/2% annually. The present Bankruptcy Law (1979) has caused a tremendous cost to Farm Credit lending institutions and to the association members. Many members facing work-out loans find that Chapter 11 of the bankruptcy laws gives two more years to drag out a loan. This is an added cost, not only to lenders but also to other members. It would be interesting to know the actual cost to lending organizations in comparison to the number of farmers who have been able to survive this route.

Lenders need help, as well as the farmers. Give farmers a chance to make a decent profit on products they produce, and problems of lending institutions will also be manageable. We do not need more credit; we need a means to pay for the credit we now have, such as an increase in commodity prices. I don't know how this can be brought about, but I do know that farmers in other countries are subsidized for their farm products in order for them to have a decent profit to continue to live on the land because these countries realize that agriculture is the most important asset they have. And I believe this is true in America today. Agriculture is the greatest asset we have. And yet it appears that agricultural support has been put on the back burner as far as priorities within this government. This present administration is concerned about foreign policy, help to Guatemala and other countries. These things take priority over helping our own people at home. I believe this is wrong. I believe that if united effort were put forth by the Congress of the United States to, by some means, feed the hungry and take the surplus products that we have on hand and get them to the people who need them or trade farm products for oil, we could see our profits and our market increase.

The American people spend less of their disposable income for food than any nation in the world. If the plight of the American farmer is allowed to continue, it could get to a point where we could put the American farmer out of business. There is one thing that everyone does every day--and that is eat. And the American farmer is the source of that food, and we need to keep that in mind.

I know this committee has many problems to deal with, but I feel this is one of the most critical ones at this time and should be dealt with as soon as possible.

Thank you for the privilege of appearing before this committee.

Robert M Hendrix Sr.

Robert M. Hendrix, Sr.

TESTIMONY OF R. C. (CLIF) COBB
BEFORE THE HOUSE AGRICULTURE COMMITTEE,
SUBCOMMITTEE ON CONSERVATION, CREDIT
AND RURAL DEVELOPMENT
CONCERNING
THE FARM CREDIT SYSTEM

MR. CHAIRMAN:

My name is R. C. (Clif) Cobb, President of Rolling Plains Production Credit Association, Stamford, Texas. On September 15, 1985 I will begin my 47th year with this Association. 1/ I have also been a Stockholder of the local Federal Land Bank Association for the past thirty years. For these reasons I have a deep and abiding interest in the welfare of the Farm Credit System as a whole.

We deeply appreciate your concerns about the economic health of the Farm Credit System as evidenced in the scheduling of these hearings. My formal statement will be concentrated largely on the Provision for Loss formulae we have been required to conform with since 1949. This and Earned Surplus Accounts constitutes the very life blood of Production Credit Associations. The March, 1985 issue of the Farm Journal quotes Senator John Melcher (D. Mont.) as follows: "In my 16 years in Congress, I have never

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1/ On September 1, 1939, I began employment with this Association as a clerk-typist, later becoming bookkeeper, chief accountant, loan officer, Vice President and the last ten years as its President.

had to get into the day-to-day operations of the Farm Credit System. They always seemed to have their business in order. But this experience points out that there is not much depth to their reserves." I am sure each of you share these feelings and have made similar observations in recent months.

Recent news releases quoting FCA Governor Wilkinson have confirmed the above, notwithstanding firm positions to the contrary just two months ago.

The Board and Management of Rolling Plains PCA has been distressed about this subject for many years. The Board has studied and discussed the annual and maximum Provision or Allowance for Loss formula in depth with increasing frequency during the past ten years. The results of these discussions and studies have been documented in position statements on numerous occasions. Unfortunately, we have been unsuccessful in getting proper attention focused on the issue by those in position to take proper action.

In this presentation I will attempt to show the following:

1. Legal history of this point in the law
2. The Farm Credit Administration's administrative policies on this issue
3. Efforts of Rolling Plains PCA to obtain recognition of problems associated with administration of the law
4. Reccomended procedures in the future

It is generally known that the Farm Credit System was originally capitalized with Federal funds. Production Credit Associations were exempt from Federal Income taxes so long as any

GOVERNMENT CAPITAL REMAINED IN AN ASSOCIATION. ROLLING PLAINS PCA COMPLETED REPAYMENT OF THAT CAPITAL IN DECEMBER, 1948, AND THEREFORE BECAME SUBJECT TO FEDERAL INCOME TAXES IN 1949.

PRIOR TO 1949, AND FOR A FEW YEARS AFTERWARD, VALUATION RESERVES (PROVISION FOR LOSSES) WERE ARRIVED AT RATHER SUBJECTIVELY. SECTION 22 OF THE FARM CREDIT ACT OF 1933 (PL 7, 73RD CONGRESS, H.R. 790, JUNE 16, 1933) PROVIDED FOR THE "CREATION AND MAINTENANCE OF A RESERVE ACCOUNT FOR BAD AND DOUBTFUL DEBTS, THE AMOUNT OF WHICH ACCOUNT SHALL BE PRESCRIBED BY THE PRODUCTION CREDIT CORPORATION." THE PRODUCTION CREDIT CORPORATION, WHICH LATER MERGED INTO THE FICB, SUPERVISED BY PCA OPERATIONS AT THAT TIME. IN 1950 THE QUESTION WAS STUDIED TO ARRIVE AT A FORMULA ADEQUATE TO COVER RISKS AND TO BE CONSISTENT WITH THE LEGAL MANDATE IN EFFECT THEN.

THE PRODUCTION CREDIT CORPORATION OF TEXAS DETERMINED THAT ANNUAL ADDITIONS OF 8/10 OF 1% WOULD BE MADE WITH A MAXIMUM PROVISION OF 4 1/2%. ACCORDINGLY, UNDER PCC INFLUENCE THE ASSOCIATION BOARD ON SEPTEMBER 22, 1950 RELUCTANTLY ADOPTED A RESOLUTION TO USE THIS FORMULA. AT THE SAME TIME, THE BOARD FELT VERY STRONGLY IT WAS GROSSLY INADEQUATE, PARTICULARLY IN VIEW OF THE NATURAL HAZARDS INVOLVED IN AGRICULTURE AND AGRICULTURAL LENDING. LOSSES SUSTAINED FOLLOWING THE DROUGHT YEARS OF 1951, 1952 AND 1956 PROVED THESE FEARS TO BE CORRECT.

ON OCTOBER 3, 1961 THE FARM CREDIT ACT OF 1933 WAS AMENDED TO PROVIDE FOR "VALUATION RESERVES AGAINST LOAN ASSETS IN AN AMOUNT EQUAL TO ONE-HALF OF 1 PERCENTUM OF LOANS OUTSTANDING AT THE END OF THE FISCAL YEAR...UNTIL SUCH RESERVES EQUAL OR EXCEED

3 1/2 per centum of loans outstanding at the end of the fiscal year beyond which 3 1/2 per centum further additions to such reserves are not required **but may be made."** (emphasis added) (PL 87-343, 87th Congress, S. 1927, October 3, 1961)

Section 2.14 of the Farm Credit Act of 1971 (PL 92-181, 92nd Congress, S. 1483, December 10, 1971), replacing previous statutes, repeated the language of the 1961 Act, as quoted above, on provision for losses for Production Credit Associations.

In January, 1977, nearly nine years ago, we began documenting our distress and anxiety about the inadequate Provision for Loss prescriptions. The following is extracted from a statement (further excerpts identified as Exhibit "A" attached) adopted by the Association Board on January 14, 1977:

> "It was the general feeling that risks inherent in agricultural lending are constantly increasing. This is due to a consistent and steady increase in size of operations, with investment requirements and expenses increasing in the same or higher ratios.
>
> "In past years when there were more agricultural operators, with smaller operations and liquidation of a loan was required, any deficiency could frequently be covered by other assets or pledge of future income. With increased average lines of credit this becomes more difficult or impossible, thus increasing the potential risk."

Board Minutes of February 11, 1977 (additional excerpts from this statement identified as Exhibit "B" attached) included the following:

> "It has been extremely gratifying to observe the numerous examples of success resulting from finance provided by the Association in recent years that could have become credit problems in a period of two or more years of adverse weather and price conditions. Since they are the beneficiaries in the cycle of favorable conditions, it is believed they should have contributed more than 1/2 of 1% to the Provision for Losses."

In studying and commenting on Capital Conservation and Loss Sharing Plans being proposed, a lengthy Board position statement on December 16, 1977 (further excerpts identified as Exhibit "C" attached) which included the following has proven to be somewhat prophetic:

> "A confederation or alliance of all Associations within the District in a Capital Conservation or Loss Sharing Plan possibly would be desirable if the basic problem of higher individual Association Provision for Losses were solved first. Rationally, it does not seem proper that a number of small problems would be solved by creating one large problem.
>
> "If conditions outlined in this statement were to develop, few if any, of the Associations in the District would be financially able to contribute to a Loss Sharing Plan. Again, this Board maintains it is urgent, and long overdue, that the present antiquated formula for building and maintaining Provision for Losses be revised to recognize the extremely high risk involved in current agricultural lending."

On January 18, 1979 when the Loss Sharing Plan was finally sold to the District by the Federal Intermediate Credit Bank of Texas, through pressures from the Farm Credit Administration, the Association Board again recorded its displeasure with the concept. A portion of this statement is quoted as follows, with the major part of the it attached as Exhibit "D":

> "We wholeheartedly agree that investors should be protected, but we do not believe the Loss Sharing Plan is sufficient within itself to accomplish this. If Associations become unable to make contributions to it when called upon, a vault full of adoption agreements will be of little benefit.
>
> "We reaffirm as forcefully and positively as we know how that risks inherent in agricultural lending in this area have increased many fold since 1955. The inelasticity of formula for building and maintaining Provision for Losses should be changed to permit more flexibility where greater

> perils exist. Although losses have been modest in the last 23 years, this is not a true indicator of the cyclical hazards involved.
>
> ""To permit an Association to become insolvent due to inadequate Provision for Losses would be somewhat analgous to the epitaph on the tombstone that read 'I TOLD YOU I WAS SICK.' We plead that preventive medicine be practiced now. If this is done, the Loss Sharing Plan might not be needed, and if it were, there would be some substance to support it."

There continued to be inattention to the problem, and on October 29, 1982 the Association Board adopted a statement some twelve legal-size pages in length that summarized some of the previous positions, took note of significant recent developments and again forecast the circumstances that have now transpired.

In the above statement we affirmed that supportive loss record existed then in many Associations to permit higher Provision for Losses and that immediate action would be tardy at best. If not, we wanted to know how many Associations must become insolvent and how much loss must be sustained to provide a supportive record for a change in its administration.

We were convinced then we could negotiate a more favorable formula with Internal Revenue Service if FCA would have supported us. However, we did not feel the outcome would be favorable for us if FCA took a position against us, or even if they remained silent.

Our own Association's history supported these fears. We have maintained through the years that Accrued Interest Receivable on Loans should be included in the calculation of annual and maximum additions to the Provision for Loss Account.

WE WERE ALSO CONVINCED IT WAS PERMITTED IN LAWS REFERRED TO PREVIOUSLY, WHICH STATED THE CALCULATIONS WERE TO BE ON LOAN ASSETS, AND WE THOUGHT LOGICALLY INCLUDED ACCRUED INTEREST RECEIVABLE. IN 1974 WE CONSULTED WITH OUR TAX ACCOUNTANT ON THE QUESTION AND WERE ADVISED TO INCLUDE IT IN THE CALCULATION. HE FURTHER ADVISED THAT INCLUSION OF ACCRUED INTEREST RECEIVABLE WAS MORE REASONABLE AND DEFENSIBLE BEFORE IRS THAN USING LOAN PRINCIPAL ONLY AS IT WAS AN ADDED DEBT BURDEN TO LIQUIDATE.

WITH THIS SUPPORT WE FILED OUR FEDERAL TAX RETURN ACCORDINGLY FOR THE 1974 TAX YEAR. ON THE NEXT FCA EXAMINATION, IT WAS LISTED AS AN EXCEPTION, BUT WE WERE NOT TOLD TO REFRAIN FROM THE PRACTICE. FOR THE 1975 TAX YEAR WE FOLLOWED THE SAME PROCEDURE. AFTER THE NEXT FCA EXAMINATION, WE RECEIVED A LETTER FROM THE FICB OF TEXAS WHICH LEFT NO DOUBT ABOUT FCA'S POSITION AND THAT WE WOULD NOT REPEAT THE PRACTICE.

IT WAS INDEED GRATIFYING WHEN THE FCA, ON DECEMBER 12, 1983 RULED THAT ACCRUED INTEREST RECEIVABLE COULD BE INCLUDED IN THESE CALCULATIONS, AS WE INSISTED COULD BE DONE IN 1974.

THE OCTOBER 1, 1982 STATEMENT DREW COMPARISONS BETWEEN COMMODITY AND LIVESTOCK PRICES OF JULY, 1952 AND JULY 1982. WITH A FEW VARIATIONS, ALMOST EVERYTHING THE FARMER OR RANCHER SOLD IN 1952 WAS ONLY SLIGHTLY ABOVE OR BELOW PARITY. IN 1982 ALMOST EVERYTHING WAS APPROXIMATELY 1/2 OF PARITY AND HAS DETERIORATED EVEN FURTHER SINCE THEN. OBVIOUSLY, THIS ACCOUNTS FOR THE MAGNITUDE OF THE PROBLEM TODAY AND SERVES TO CHAMPION THE CAUSE WE HAVE DESPERATELY TRIED TO FOCUS ATTENTION UPON. WHILE COMPARISONS WITH PARITY MAY HAVE LOST SOME OF ITS VALIDITY DURING THE years, it nevertheless points out the basic problem very vividly.

The October, 1982 statement concluded with the observation, "Preparation for the circumstances that now confront us should have begun at least a decade ago. TODAY MAY BE TOO LATE." A more complete excerpt is attached as Exhibit "E."

Other position statements were adopted by our Board on December 10, 1982 and May 17, 1984 relating principally to the ills of the agricultural economy, with excerpts of these attached as Exhibits "F" and "G" to this testimony. A brief quote from the latter statement follows:

> "As we understand our present position, it is necessary to document the need for additional reserves before we can increase them. But to do this, we must become virtually insolvent and trigger the Loss Sharing Plan. IT IS HARD TO BECOME REALLY EXCITED ABOUT GOING BROKE TO PROVE THE NEED FOR ADDITIONAL PROVISION FOR LOSSES."

In PCA examinations of recent years, management representation letters also have been consistent with this thinking.

The effect of all of this is that figuratively we are required to walk across a river 100 feet wide which averages 3 1/2 feet in depth. However, if about 30 feet of the span is 7 feet deep many PCA's will drown in their attempt to negotiate it. Yet, the current view is that you should not drown, for after all the water only averages 3 1/2 feet deep, and if you even come close to going under, all kinds of sanctions will be invoked. Then management, whose hands have been tied for years, is held fully accountable. If we could program our losses so they would come annually, the survival rate would be higher. However, when all our loan portfolio is concentrated in agricultural enterprises, loss provisions must anticipate the depth of the water at its deepest point, certainly not its average depth.

Generally Accepted Accounting Principles recognize the above, as these principles require an allowance to cover estimated losses in the loan portfolio. However, our accounting and annual financial reporting have pointed out consistently that it conforms with GAAP, except with respect to the accounting for Allowance for Loan Losses.

We believe loss provisions must be in accordance with GAAP, and due to the concentration of the portfolio in agriculture with its related hazards, any provision up to 7% in PCA's should be permitted. Then the annual addition should be flexible enough to comply with GAAP.

A recent policy statement, although tardy by about ten years, by FCA on this question is indeed gratifying in some respects. However, Bank and Association management may suddenly be held accountable for GAAP in this financial area without having the opportunity to apply its principles during the period in which in building and maintaining adequate loss provisions could have been made more easily.

I will conclude this portion of the testimony by observing that if proper attention had been given to the above during the past ten years, the Farm Credit System would not be undergoing the scrutiny and rigors it is today. Admittedly, some District Banks who lost sight of sound credit principles and certainly some Associations would have failed even with these preparations, but the preponderant number of others would have had financial strength to support them. If these preparations had been made, pressure for mergers of PCA's would not be so widespread. The System as a whole would have been in much better position to ride the cycle to the bottom, then start with a fresh beginning.

As it now stands, we are being called upon to lend support all over the country when all our resources are needed locally. In some quarters any reluctance to do so is described as a "parochial" view. When an Association has closely monitored expenses, made frugal decisions on its investments in office buildings, maintained as good credit quality as possible and built strong Surplus accounts with after-tax dollars, it is hard to get excited about mergers and other dilutions of capital. Quite naturally, they are scrutinized very closely. Notwithstanding these considerations, we stand ready to assist elsewhere to the extent we can can without jeopardizing our own economic health, but there is a limit to the number of times you can donate at the blood bank. It is too good a System and too valuable to the nation's agricultural economy to allow it to fail. Surely it is worth as much to the nation as one of its major commercial banks.

There are many issues of current interest I would like to address if time permitted but would like to touch very briefly on a few.

The "at risk" feature of Association Class B stock has become a major issue. As it now stands, it cannot be denied that it is subject to impairment. The engagement of outside auditors and the overkill consequential to it by them and FCA can throw the whole system into an uproar. Facts need to be disseminated, but ten or fifteen page disclosures would be so cumbersome, they might do more harm than good.

Since Class B stock investment is a requirement for obtaining a loan and if the "at risk" aspect is to be strictly enforced, some method of insuring this risk should be devised. If the investment were optional, there would be basis for risk exposure, but since it is not, risk can only be avoided by refusing to accept the loan. This will become a greater obstacle in the future in new business development. As we understand it, on this issue, there have been different policies followed in liquidation or reorganization of PCAs in different Farm Credit Districts, which spotlight the need for insurance to assure consistency.

It seems to us in the country that little consideration is given to the impact various FCA directives and policies have upon the borrower. Implementation of some of these tends to make larger borrowers very wary and is eroding confidence that has been built through the years in the System.

Currently, an area in which FCA seems to be extremely zealous is designation of persons authorized to vote stock owned in an Association. For over 50 years this has been no problem, and all of a sudden it becomes a major issue. Again, no consideration seems to have been given to the effect all these administrative requirements have upon the individual stockholder.

Several years ago a system of Borrower Surveys were begun for statistical purposes. Initially, it began with a small sampling and has increased in scope until in 1986 will be required on every loan made. The goal was to progress to the point where it could be computer generated, but that method is still somewhat in the future. In the meantime, gathering and reporting this information will be virtually as time consuming for our staff as the loan applications themselves. In addition many precautions must be made and certain expenses incurred to safeguard confidentiality of the information reported.

The intent of the Truth-in-Lending law is good and serves a useful purpose. However, for anyone as highly regulated as the Farm Credit System, there is no way we can violate the spirit of it, yet disclosure requirements add extensively to our administrative burden. Some method should be devised whereby our examiners could check us for compliance and, if found out of compliance, impose penalties. Our borrowers are totally unconcerned with the completion and receiving this information, and it constitutes a wholly unnecessary burden for them and us.

We support the single management concept at the District Bank level and believe it will be a constructive step forward when permitted to operate independent of the present shadow of legal action in our District. Indications are that progress is being made despite this. We have many friends in Land Bank Associations who feel otherwise, and we respect their opinion as we trust they will ours.

On this issue we believe the overall credit needs and flexibility of its administration, for the average farm or ranch operator, is overlooked. We could list many reasons for holding to the position but time does not permit.

We will continue to support the tax exempt status of the Federal Land Bank and Federal Land Bank Associations. Although, at times it is surprising to some familiar only with FLBA operations that a comparatively small organization like Rolling Plains PCA has paid in excess of $1,700,000 income taxes in the past six years.

During the first 30 years or so of the existence of the Production Credit System, I, along with many of my contemporaries, worked with almost evangelistic fervor to advance and promote the PCA concept of agricultural lending. With all the unyielding policies, rules and regulations imposed in recent years, there has been an obvious change in attitudes of officers and employees at all levels of the Banks and Associations. Loyalties that once existed have diminished somewhat, some of which may be attributed to sociological change, but certainly not all. We believe there should be a general review, with genuine input from Banks and Associations, of existing policies and regulations, and how they are administered, to determine their effect on employee morale and the resulting impact on the entire System.

Through the years FCA has countered these arguments with many reasons why proper loss provisions cannot be made. Yet, the things we warned of have transpired. Since we work with these problems on a daily basis, we thought we were in better position to relate to them than those far removed and insulated from them. The balance in Provision for Loss Account in PCA's in large measure dictates lending policy. Whereas, conservative lending policy should be adhered to with Provision for Losses maintained in keeping with risks identified in that portfolio.

Even though we have long predicted it would happen unless we were prepared for it, we gain no satisfaction in the announcement made by Governor Wilkinson as quoted in The Wall Street Journal of September 4, 1985 that the System "cannot absorb the losses we face." The secondary market in FCS bonds has made a rather dramatic change during the past few days as a result of the adverse statements of last week. For example, on Friday, August 30, 1985 bonds with a maturity of September 1986 were trading to yield 8.02%. On Thursday, September 5, trade prices would yield 8.64%. If these differential prices continue to prevail, it will create an additional large economic burden on Farm Credit System borrowers. In the same period, there was no appreciable change in the secondary market on other similar bonds. When problems arise, it is usually accompanied with finger pointing. There will be charges of lack of legal administrative authority to control all the various Banks and Associations. However, the fact of the matter is that those isolated from the battlefield refused to see it coming and would not listen to warnings of those who could.

(The attached exhibits are held in the committee files.)

TESTIMONY OF SENATOR GARY HART, (D) COLORADO

BEFORE THE HOUSE AGRICULTURE COMMITTEE
SUBCOMMITTEE ON CREDIT AND CONSERVATION
SEPTEMBER 11, 1985

"GIVING CREDIT WHERE CREDIT IS DUE"

CHAIRMAN JONES, MR. COLEMAN AND DISTINGUISHED MEMBERS OF THIS SUBCOMMITTEE: THANK YOU FOR AFFORDING ME THIS OPPORTUNITY TO DISCUSS AN ISSUE OF CRISIS PROPORTION.

FEW ISSUES FACING THE CONGRESS THIS YEAR ARE OF GREATER IMPORTANCE THAN THE CREDIT CRISIS FACING RURAL AMERICA. EMERGENCY FARM CREDIT PASSED THIS SESSION WAS VETOED BY THE PRESIDENT. THE USDA HAS CHOSEN TO DISALLOW ANY NEW LOANS TO HARD-PRESSED FARMERS UNDER FMHA LOAN PROGRAMS AND FARM CREDIT LAND BANKS AND PRODUCTION CREDIT ASSOCIATIONS HAVE MOVED SWIFTLY TO REORGANIZE IN A FASHION WHICH WILL PROVIDE GREATER STABILITY AGAINST THE CURRENT ECONOMIC CONDITIONS.

THE U.S. GOVERNMENT HAS AN OBLIGATION TO SUPPORT THE FARM CREDIT SYSTEM. WE CREATED THE SYSTEM TO SOLVE THE PROBLEMS OF FARMERS DURING THE DEPRESSION. TIMES WERE VERY MUCH AS THEY ARE NOW; FALLING LAND PRICES, INADEQUATE PRICES FOR CROPS AND TREMENDOUS DEBT LOAD WHICH FARMERS COULD NOT MEET AND FINANCIAL INSTITUTIONS COULD NOT BEAR.

THIS YEAR OUR MAIN PURPOSE AS FRIENDS OF AGRICULTURE AND RURAL AMERICA IS TO MAINTAIN FARM INCOME AT LEAST WHERE IT IS NOW. WE MUST ALSO BOLSTER THE FARM CREDIT SYSTEM AGAINST HIGH INTEREST RATES, INCREASED LOAN DELINQUENCIES AND LOSS OF PREFERRED CUSTOMERS TO COMMERCIAL LENDING ENTITIES.

WE MUST ACT IN SEVERAL WAYS. WE MUST AGREE ON A UNIFIED APPROACH TO THE PROBLEM. WE MAY NOT BE ABLE TO DO MORE FOR AMERICA'S FARMERS UNDER THE CURRENT CLIMATE OF DEFICITS AND RUNAWAY MILITARY SPENDING, BUT WE MUST NOT DO LESS.

I BELIEVE WE MUST PROVIDE A BACK STOP, NOT A BAIL OUT, FOR FARM BANKS.

THE SECOND QUARTER PROFIT STATEMENT FOR THE FARM CREDIT SYSTEM SHOWED A RAPID DROP OF 96%. THERE IS A PROJECTED LOSS FOR THE THIRD QUARTER. PART OF THE PROJECTED LOSS COMES FROM INTERNAL EFFORTS TO STRENGTHEN BELEAGUERED SYSTEMS IN OMAHA AND SPOKANE. THAT HAS REQUIRED AN INFUSION OF FUNDS FROM SISTER REGIONS OF THE SYSTEM.

THERE ARE OTHER SIGNS THAT CONDITIONS HAVE WORSENED,HOWEVER. FEDERAL LAND BANKS WHO HAVE SHOWN MORE

RESILIENCE IN THE PAST AGAINST THE ADVERSE FARM ECONOMY ARE NOW SHOWING A JUMP IN UNCOLLECTABLE LOANS. THE TOTAL FOR THE ENTIRE SYSTEM SWELLED TO $159 MILLION DOLLARS FOR THE FIRST SIX MONTHS OF THIS YEAR AS CONTRASTED WITH $122 MILLION DOLLARS IN BAD LOANS WHICH THE SYSTEM WROTE OFF FOR ALL OF LAST YEAR.

THIS INFORMATION FILED BY THE FARM CREDIT SYSTEM DOESN'T EVEN REFLECT UNCOLLECTABLE LOANS BY THE SYSTEM'S CREDIT ASSOCIATIONS WHICH ARE REPORTED SEPARATELY. SENIOR OFFICIALS OF THE SYSTEM HOWEVER, PREDICT THOSE WILL EXCEED OR EQUAL LAST YEAR'S RECORD $284.7 MILLION.

WE ARE NOW TOLD THAT THE FARM CREDIT SYSTEM HOLDS OVER $11.5 BILLION DOLLARS IN NON-PERFORMING LOANS. AN INFUSION OF FUNDS THROUGH FARM MORTGAGE REFINANCING, INCREASED FARM INCOME OR DIRECT GRANTS BECOME NECESSARY. THE ALTERNATIVE IS POTENTIAL BANKRUPTCY OF THE SYSTEM, DEVALUATION OF BONDS, AND INCREASES IN FARM FORECLOSURES.

WE MUST AVOID THE IMPRESSION A DISASTER HAS ALREADY HAPPENED. THERE HAS NOT BEEN ONE YET AND IF WE ACT QUICKLY THERE WILL NOT BE ONE. BOND INVESTORS WHO SUPPORT THE FARM CREDIT SYSTEM SHOULD KNOW THAT THE SITUATION IS STILL MANAGEABLE AND THE CONGRESS WILL ACT. ALONG WITH CHANGES BEING MADE TO STREAMLINE THE DELIVERY OF FARM CREDIT AND LOWER OVERHEAD, THE CONGRESS MUST MAKE CERTAIN GUARANTEES.

NO ONE WANTS TO REFEDERALIZE THE FARM CREDIT SYSTEM COMPLETELY. TO RETURN THE SYSTEM TO ITS FORMER HEALTH WILL REQUIRE A SPIRIT OF COOPERATION AMONG THE PRIVATE SECTOR, GOVERNMENT AND THE FARM CREDIT SYSTEM. HELPING THE FARMER WILL HELP ALL OF US.

1. AS WITH THE FEDERAL DEPOSIT INSURANCE CORPORATION AND THE FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION WE CAN STAND BEHIND THE WORTH OF FARM CREDIT BONDS AS WE DID WHEN THE SYSTEM WAS FIRST CREATED. WE CAN ACT DIRECTLY AND INDIRECTLY. FUNDING OF THE SYSTEM MUST BE ACCOMPLISHED BUT MUCH OF THE AID SHOULD BE DIRECTED THROUGH FARMERS THEMSELVES. A PREVENTED FORECLOSURE KEEPS A FARMER ON THE LAND AND GIVES THE BANK A PAYING CUSTOMER.

2. WE CAN AUTHORIZE THE REFINANCING OF LOANS OVER A 20-30 YEAR PERIOD AT REDUCED INTEREST RATES TO PREVENT LIQUIDATIONS. I HOPE THE COMMITTEE WILL PROVIDE A DEFINITION OF POSITIVE CASH FLOW THAT WOULD INCLUDE FARMERS AT THE BREAK EVEN POINT. MANY FARMERS WOULD BE SHOWING PROFIT WERE IT NOT FOR INFLATED INTEREST RATES.

3. WE SHOULD RE-INSTITUTE A FEDERAL FARM MORTGAGE TYPE CORPORATION SUCH AS EXISTED PRIOR TO 1943. IT SHOULD BE ALLOWED TO LEND TO FARMERS BASED ON A REASONABLE LAND VALUATION AT FIXED LOW INTEREST RATES. THESE LOANS WOULD BE

LONG-TERM AND SHOULD PROVIDE AN INCENTIVE FOR FARM BANK AND PCA PARTICIPATION IN DEBT NEGOTIATION.THEY COULD BE ORGANIZED AS A DIVISION OF THE FMHA AND RELY ON DIRECTION BY COUNTY COMMITTEES.

4. ANY FARM MORTGAGE CORPORATION WILL LIKELY BE GIVEN THE AUTHORITY TO RELIEVE LENDERS OF NON-PERFORMING LOANS THROUGH A DISCOUNT MECHANISM. RATHER THAN FORCE LIQUIDATIONS, BANKS SHOULD RE-NEGOTIATE LOANS AND DIRECT ASSISTANCE SHOULD BE CONTINGENT ON BANK ACCEPTANCE OF RE-NEGOTIATION CRITERIA. ANY SUCH PLAN SHOULD ATTEMPT THROUGH EVERY MECHANISM TO MAINTAIN THE CURRENT LANDOWNER IN POSSESSION OF THE LAND.

5. ANY LAND ASSUMED UNDER SUCH A CORPORATION SHOULD BE ENTERED INTO A CONSERVATION RESERVE OR OTHERWISE WITHHELD FROM THE LAND MARKET AS A MEANS OF SLOWING LAND PRICE DECLINES.

6. I HOPE THE COMMITTEE WILL ACHIEVE THE LOWEST POSSIBLE COST OF MONEY TO THE FARM MORTGAGE PROGRAM. COST OF BORROWING PLUS 1% FOR ADMINISTRATION WOULD BE THE MOST DESIRABLE LEVEL IF FEASIBLE.

BY HELPING THE FARMER REFINANCE AT REASONABLE INTEREST RATES WE WILL MAINTAIN OUR DIVERSE FARM COMMUNITIES. WE WILL BACK UP THE FARM CREDIT SYSTEM AND ACHIEVE FINANCIAL STABILITY AND INVESTOR CONFIDENCE IN THE BOND MARKET.

THE PROBLEMS OF THE FARM CREDIT SYSTEM CANNOT BE VIEWED AS SEPARATE FROM THOSE OF THE FARM ECONOMY IN GENERAL. WE CANNOT ASK FARMERS TO ACCEPT PRICES BELOW THE COST OF PRODUCTION AND EXPECT THEM TO SURVIVE. LIKEWISE WE CANNOT EXPECT THEIR CREDIT INSTITUTIONS TO REMAIN VIABLE.

WHILE OTHER COUNTRIES SUBSIDIZE THEIR FARMERS AGAINST LOW WORLD PRICES, EXPAND THEIR SHARE OF EXISTING MARKETS AND PROVIDE TARIFFS AGAINST AMERICAN FARM GOODS, WE ARE ASKED BY THIS ADMINISTRATION TO THINK IN TERMS OF LOWERING FARM INCOME, SACRIFICING A MINIMUM OF 10 TO 20% OF OUR PRODUCERS AND WATCHING OUR EXPORT MARKETS DIMINISH.

I HAVE LONG BELIEVED THAT FARM PROGRAM PAYMENTS SHOULD BE TARGETED SO THAT THEY HELP MAINTAIN THE SMALL AND MEDIUM SIZED FAMILY FARMS. I HAVE ADVOCATED A TIERED APPROACH TO OUR SUPPORT SYSTEM WHICH PHASES OUT AT HIGHER VOLUMES OF PRODUCTION.

LIKEWISE LET US GIVE CREDIT WHERE CREDIT IS DUE. IT IS OUR SMALL AND MEDIUM SIZED FAMILY FARM PRODUCERS WHO ARE UNDER THE GREATEST STRAIN. THEY REPRESENT A WAY OF LIFE AND AMERICAN VALUES WHICH ARE MORE THAN ROMANTIC NOTIONS. THEY WORK HARD, THEY ARE EFFICIENT AND PRODUCTIVE, THEY FEED US ALL AND THEY RECEIVE LESS THAN THEIR COST OF PRODUCTION.

MAINTAINING A BROAD BASED FAMILY FARM SYSTEM OF FOOD PRODUCTION IS A NATIONAL SECURITY ISSUE TOO. SUPPORT OF THE FARM CREDIT SYSTEM IS AN ESSENTIAL MAINTENANCE PROJECT.

AGRICULTURE EFFECTS 23% OF OUR GROSS NATIONAL PRODUCT. ITS COLLAPSE WOULD BE FELT FROM THE FARM TO THE CORPORATE BOARDROOMS OF WALL STREET. IT MIGHT EVEN BE FELT AT THE WHITE HOUSE AND THE OFFICE OF MANAGEMENT AND BUDGET.

A RECENTLY RELEASED WHARTON ECONOMETRIC STUDY TELLS US THAT FAILURE TO SUPPORT FARMERS AT LEAST TO THE EXTENT OF MAINTAINING FARM INCOME AND SUPPORTING THEIR FARM CREDIT SYSTEM, COULD COST US $13-$18 BILLION DOLLARS IN THE NEXT EIGHT YEARS. THAT WOULD RESULT JUST FROM THE NUMBERS OF JOBS LOST AND THEIR IMPACT ON THE FEDERAL DEFICIT.

THE GNP WE ARE TOLD COULD SUFFER $30 TO $49 BILLION IN REDUCTIONS OVER THE SAME PERIOD. WE MUST HOLD THE LINE ON GROWTH OF THE FARM DEBT. WE MUST OVERCOME THE GROWTH OF UNPAID INTEREST. IF WE CAN RESCHEDULE FARM DEBT WE CAN PREVENT A RIPPLE EFFECT THROUGHOUT THE WHOLE ECONOMY.

WE MUST NOT ALLOW OUR FARMERS TO SINK; RATHER, WE SHOULD SWIM IN NEW WATERS. REGARDLESS OF PARTY THIS CONGRESS SHOULD NOT LET PARTISAN CONSIDERATIONS STAND IN THE WAY OF A SOLUTION TO THIS NATIONAL PROBLEM. WE MUST SLOW FORECLOSURE RATES, WE MUST PROTECT OUR RURAL COMMUNITIES FROM IMMEDIATE DANGER OF DEMISE, AND WE MUST INSULATE THE NATIONAL ECONOMY FROM THE DISASTROUS EFFECTS AN ABANDONMENT OF OUR FARM ECONOMY WOULD ENCOMPASS.

THANK YOU.

Bob McEw

STATEMENT BY CONGRESSMAN BOB McEWEN

BEFORE THE HOUSE AGRICULTURE COMMITTEE

SUBCOMMITTEE ON CONSERVATION, CREDIT AND RURAL DEVELOPMENT

SEPTEMBER 11, 1985

CHAIRMAN JONES, CONGRESSMAN COLEMAN, and distinguished members of the Subcommittee. Under normal circumstances it would indeed be a pleasure to be addressing and working with you to meet the credit and development needs of our Nation's agriculture and rural populations.

However, today, with the severity of the farm credit crisis made more blatantly clear through the recent announcements by Governor Donald Wilkinson of the Farm Credit Administration, it is in unfortunate, rather than fortunate, that I come before you to speak for the residents of Ohio's Sixth Congressional District.

As many of us have stated for the past year or so, the announcement of the potential for bankruptcy by the nation's largest agricultural lending institution, the Farm Credit System, comes as no surprise. It is unfortunate that it wasn't until just last week that the Governor of the Farm Credit Administration - the regulatory agency for the Farm Credit System - finally came forth to the public with the news. It is imperative that this Congress act swiftly and in unison to help stave off this bankruptcy -- before it's too late. A partial bandaid would be almost as bad as no bandaid at all.

This winter, as the bumper crops predicted by USDA reach market and command even lower prices than in 1984, the situation will worsen. Renewals by lending institutions on short term loans will lessen. Delinquencies on long term loans will increase. Realizing that the agriculture scenario is continuing on its downward trend, the commercial lending institutions will move more swiftly to get out of agricultural lending. Simply stated, this Congress cannot afford to allow the Farm Credit System to "go under" as well. The situation is bad. The situation is severe. And the situation is getting worse.

Mr. Chairman, there is no need for me to reiterate the comments made by my distinguished colleagues before this Subcommittee. I must close by stating again, however, that the Congress must be willing to act in the best interest of the agricultural industry and its farmers, as well as the Nation, and save the Farm Credit System. We saved Chrysler. We saved New York City. Let us now join together to save the American farmer.

TESTIMONY OF
MR. ORIS O. TAYLOR
O. TAYLOR ENTERPRISES
GUTHRIE, OKLAHOMA

Mr. Chairman, I appreciate the opportunity to appear before this Subcommittee to offer my views on solutions to correct the FCS.

I. INTRODUCTION

I have spent my entire life on the farm and have a degree in Agriculture. I also heve moonlighted to make a living at such things as Management for USDA; Sales Manager in Insurance; and Real Estate Broker in both small and large concerns, buying and selling real estate in such a manner that my clients include all types of farmers in the Southwest.

I have owned a large grain elevator and feed/fertilizer business. I have spent time on a Production Credit Association Board of Directors and think I have a better than fair knowledge of agriculture finance and most especially have a knowledge of current farm problems.

II. CURRENT SITUATION ---- FARM PROGRAM

The current farm problem is a many legged beast. Farm programs of allotments, commodity loans and acreage controls have never worked and in my opinion made more problems for the farmer than they have solved. They have provided the American people the best food in the world at the lowest cost. The programs have fed the aged and school children with some left to send abroad and called it all the farm program.

III. FARM CREDIT

The current and past administration in Farm Credit has been for bigger and better programs for bureaucrats and has completel forgotten the farmer whom they were to serve. They have promoted new multi-million dollar office buildings for Regional Offices; larger and more attractive new District Offices; and airplanes to haul personnel to and from plush meetings that did little if anything to solve the farm problems. The salaries paid are in the top bracket of salaries paid in similar positions in both government and private industry.

To accomplish their goals of being the greatest, they have encouraged loaning money on short time trends to persons who were seekers and not farmers. They have expanded farm operations where it was not feasible. The debt load became excessive and when interest rates rose and inflation stopped, farm economy went down hill. They then changed to shorter time for trends, deflated the land vales and other capital investment to the point where net worth showed about zero compared to what it had been which was a figure as large as the farmers investment. For instance, a farmer with a net worth of $500,000.00, who owes $500,000.00 on a $1,000,000.00 land and equipment investment now becomes a candidate for foreclosure. The mid-wes is full of examples. The only thing that has not depreciated is commercial property.

As a beginning toward solving some of the problems, why not sell all the airplanes and fancy office buildings to help cover the loss on farm loans. If they do not, they will not need the office space as the farmers will all be out of business. Secondly, as manufacturers have had to do, personnel could take a cut in salary in order for the organization to stay alive. They cannot match their current salaries anywhere in the market place. Thirdly, break the hold that the bureaucrats in Washington and elsewhere have on farm credit.

(a) Sell tax exempt bonds on a local-regional basis. "He who holds the gold makes the rules".

(b) Give Production Credit Association a non-profit tax exemption as other Credit Unions have. This could help develop a capital reserve to off-set losses, more effectively and efficiently to certain areas through bad times. Local P.C.A.'s did not have enough capital resource because of the income tax of our 46% of profits over $100,000.00 per year.

(c) Allow farmers to "roll over" their capital from real estate and capital investments to Farm Credit tax exempt bonds, without prejudice, (payment of capital gain until bonds are cashed).

(d) License farmers by such requirements as percentage of net gross income from farming in order to qualify for loans and "roll over" of capital.

I know many retired farmers who have purchased tax exempt bonds and would have gladly purchased a Farm Credit Bond had they been aware of the availability of them.

I know of retirement funds now purchasing land to speculate on and do sell this land to reinvest in other land. So why not let farmers have the same privilege.

If we are going to develop a Capital Reserve, set up a requirement as to who is eligible for these loans so that this lower rate will be available to farmers only.

One of our problems now on land prices is the Federal Land Bank made loans to industries and thereby brought about competition with the farmer for available land. In recent years, the majority of loans were to investors not farmers.

There should be some factor to stabalize land prices such as a 10 year average of land values. This would prevent inflationary lending caused by investors purchasing. We had this very bad in the late 1970's and early 1980's. The Federal Land Bank was making house loans similar to FHA which they said was to gain more volume.

Use the same principle to stabalize prices on other capital investment such as cattle and equipment, but probably using a 5 year average.

There is an instance in our area where a farmer expanded in the 1970's and put in a center pivot irrigation system. He took out bankruptcy and the Federal Land Bank took a $300,000.00 loss. The experience of the 1930's and 1940's tell us that a farmer in this sort of situation could and in many instances did survive and pay off all the debt. The farmer today cannot do this on 15 and 16 percent interst.

There are three things that work together to break farmers, which are:

1. Cash flow due to lowering prices at the market
2. High interest rates and short time loans
3. Loss of net worth due to using current market values

I have witnessed very few farmers who willingly sold their operation except because of their age. No one wishes to be a loser.

Thank you for letting me submit my ideas. There must be a plan for agriculture to develop finance suitable to the needs of agriculture. Clyde Cheatham and I had this problem in the grain and feed business. My impliment dealer has the same problems. Most of all, is the professional farmer who needs a credit suitable for his needs in agriculture. If he had good credit sources, it would help stabalize all of agri-business. Agriculture is a long time project and cannot survive on short time finance.

I still think Chandler Production Credit Association was on the right track of staying with persons who had knowledge of agriculture and were willing to make adjustments and had the guts to continue to try to retire their debt.

Best Regards,

Oris O Taylor

Oris O. Taylor
O. Taylor Enterprises
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Guthrie, Oklahoma 73044
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AGRICULTURAL CREDIT CONDITIONS

THURSDAY, SEPTEMBER 12, 1985

House of Representatives,
Subcommittee on Conservation, Credit,
and Rural Development,
Committee on Agriculture,
Washington, DC.

The subcommittee met, pursuant to recess, at 10 a.m., in room 1302, Longworth House Office Building, Hon. Ed Jones of Tennessee (chairman of the subcommittee) presiding.

Present: Representatives Weaver, Stenholm, Tallon, Evans of Illinois, Thomas, Stallings, Morrison, Gunderson, Evans of Iowa, and Franklin.

Also present: Representative E (Kika) de la Garza, chairman of the committee; Representative English, member of the committee; and Representative Madigan, ranking minority member of the committee.

Staff present: Mark Dungan, minority associate counsel; Glenda L. Temple, clerk; Robert A. Cashdollar, James W. Johnson, Jr., Fred Clark, Bernard Brenner, and Susan Adkins.

OPENING STATEMENT OF HON. ED JONES, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE

Mr. Jones of Tennessee. Good morning. The Subcommittee on Conservation, Credit, and Rural Development will come to order.

Following yesterday's testimony, which was for several hours with a total of 20 Members of Congress being heard yesterday, and then an additional number of concerned people as far as farm credit is concerned from the production credit associations, from the Federal land banks, and from other organizations in general and also some farmers, today we will continue this same procedure and, as I begin, we will begin with the first panel, panel No. 1, and I must mention on the front end that we have one other Member of Congress who wishes to be heard sometime today. He is not here this morning. And when he arrives, with your indulgence, I'll interrupt whatever we're doing to allow him to be heard and then proceed with our usual work.

I do have a statement, a short one, that I want to make that has something to do with the hearings. Today we continue with the second day in a series of hearings that this subcommittee will conduct over the next few weeks to examine current agricultural credit conditions and problems, with a particular focus on the cooperative Farm Credit System.

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Yesterday we heard from over 30 witnesses, including 20 Members of Congress from both the House and Senate. Around the 1st of October we will convene another session of the subcommittee to hear from the Farm Credit Administration, officials of the Farm Credit System, the Department of Agriculture, major commercial bankers' associations, and others.

This morning we will again hear from interested Members of Congress; we will then proceed with two panels, the first consisting of representatives from agriculture-related organizations, and the second consisting of Farm Credit System borrower/members.

I request that each witness confine your oral testimony to less than 10 minutes, with the assurance that all written statements will be included in the official record in their entirety and will be reviewed by members of the subcommittee at a later time.

I expect to conclude today's hearings around the noon hour without continuing with an afternoon session.

At this time I will recognize the first member of the panel who is here and ready to proceed, and then we'll continue with the panel until a Member of Congress shows up.

The first member this morning is a close personal friend of mine. He is from my congressional district. He is an outstanding farmer; he is a former national chairman of the National Agriculture Movement, and is still very active in the American Agriculture Movement. With that, I turn it over to Tommy Willis of Brownsville, TN, for whatever he desires to say.

Tommy.

STATEMENT OF TOMMY WILLIS, EXECUTIVE VICE PRESIDENT, AMERICAN AGRICULTURE MOVEMENT

Mr. WILLIS. Thank you, Mr. Chairman. I am Tommy Willis, as you've already said, a farmer from Brownsville, TN, and I'm presently serving as executive vice president of the American Agriculture Movement.

The usual procedure would be to say that it is a pleasure to be here today to discuss what has been termed the Farm Credit System bailout. Actually, I find it most regrettable that any of us have to be here.

Due to the lack of any specific proposals, I would like to talk in general about the concerns of some of our membership, many of whom depend on the system for their credit needs.

It is a fact that the Farm Credit System is in trouble because of the agricultural crisis. This crisis has set in motion a downhill slide which is snowballing.

The idea behind the Farm Credit System was two-fold: First, to provide capital at reasonable interest rates to agriculture; and second, to be farmer owned and controlled. Recently, we have seen their interest rates rise above that of other financial institutions, partly because of the losses which they have suffered due to bankruptcies and so forth, and also because of the negative effect caused by falling interest rates. This has caused many good borrowers to leave the system in search of cheaper interest.

There is presently talk about consolidation of all the local production credit associations and Federal land banks in each district into single units, each with one board at the district level, thus eliminating the local boards. Should this happen, we will see the remaining good borrowers leave the system, thus creating another lender of last resort and weakening the system further.

Another concern of the AAM is a proposal which would create a Government-owned corporation known as the Agricultural Conservation Corporation, the function of which would be to take foreclosed-upon land, hold it for 10 years, and lease it back to the farmer-owner at a reasonable rate. At the end of this 10-year period the land would be sold at market price, but during the 10-year period, it could be sold at 115 percent of the entrance figure. We of the AAM view this as a potential land grab by big-money interests; therefore, we of the AAM would oppose any bailout in which the title to foreclosed-upon land is not held by the Farm Credit System, which is farmer-controlled.

It has been suggested that the guaranteed loan programs of FmHA be expanded as a solution to the problem. Should such be possible, this committee must legislate the guidelines for qualifications and not leave the regulations to be written and interpreted by the USDA. Presently, few farmers qualify for these loans. There are many reasons; the most frequent reason for denial is the interpretation of family farm. The present interpretation is often used as an excuse not to make loans, rather than a reason.

In recent years, we have seen many credit programs implemented in the name of agriculture credit to help the farmer. The reality is that they have been bank bailouts. This was the case with the Small Business Administration loans in the late 1970's, the economic emergency programs, disaster loans, guaranteed loans, and to a degree, the PIK Program. Some of these programs were intended as bailouts because a certain percentage had to go for existing loans or debts; others just worked out that way.

Thank goodness, we are finally calling an ace an ace, a spade a spade, and a bank bailout a bank bailout. We must ask ourselves, is this a bailout of the banks in the Farm Credit System or is it a bailout of Wall Street banks?

If we are honest with ourselves, we know that the only way to solve the problem is to have a profit in agriculture so that farmers can once again cash-flow their operations. Then, and only then, can we have a true bank bailout.

With these thoughts in mind, the AAM is forced to oppose any bank bailout until there is a farm bill which promises to place a profit back in agriculture.

I hope that my thoughts and our actions will be taken in the proper perspective by this committee, for we know that we probably have more friends here than anywhere else in Congress.

I thank you.

Mr. Jones of Tennessee. Thank you very much, Tommy, for a good statement, and I can assure you that although the Members are not here this morning—I can understand why they are not here—your statement will be exposed to the full subcommittee and anybody else who wants to see it on the full Agriculture Committee. And without a doubt, we'll be in touch with you at some future date to discuss your proposals.

Our next witness is Mr. Stewart Kohl of the National Cooperative Business Association here in Washington.

Mr. Kohl, welcome.

STATEMENT OF E. MORGAN WILLIAMS, PRESIDENT, NATIONAL COOPERATIVE BUSINESS ASSOCIATIONS, PRESENTED BY STEWART KOHL, EXECUTIVE VICE PRESIDENT AND CHIEF OPERATING OFFICER

Mr. KOHL. Thank you very much, Mr. Chairman. First, let me say thank you for allowing me to appear here today, and particularly to represent our president, Morgan Williams, who is unable to be in town.

I am the executive vice president and chief operating officer of the National Cooperative Business Association, a national membership and trade association representing all types of cooperative businesses, including the major agricultural marketing and supply cooperatives. These cooperatives are democratically owned and controlled by other cooperatives and/or by their farmer-members, and they rely on the Farm Credit System as one of their major sources of financing.

Since 1916, the Farm Credit System has existed in order to meet the credit needs of farmers, ranchers, and their cooperative businesses. The system has not only provided the farmers in this Nation with the credit that has enabled them to become the most efficient producers in the world, but has also served the general public by making it possible for the producers of our food and fiber to ensure an ample supply of high-quality goods at low cost. In good times and bad, for over 60 years, the Farm Credit System has provided loans to creditworthy borrowers in rural America.

The farmers and cooperatives that borrow from the system become owners of the system by purchasing stock when borrowing from the system. This is a requirement to be eligible for loans.

To launch the system, the Government first invested in the Federal land bank capital stock. You will recall that many were skeptical that the Government's investment would ever be repaid. The land banks and other parts of the system have long since paid off all their Government capital. Today, thanks to the system's excellent record of repayment, other organizations have been created along similar models, such as the Export-Import Bank, Federal Deposit Insurance Corporation, Federal National Mortgage Association, the Federal Home loan banks, and the like.

By repaying the Government in its entirety, the system became farmer-owned, with less reliance on Government. The system has retained a close working relationship with the Government, however, through its regulatory agency, the Farm Credit Administration.

Today, the system has net loans of $74 billion but is suffering net losses for the first time since its creation. The deterioration of agriculture continues to worsen and some parts of the system are facing continuing and staggering losses, despite agreements to share losses among all the banks. One of the major goals of the cooperative Farm Credit System is to provide credit to its users at the lowest possible cost; therefore, loan money must be obtained at the lowest possible cost.

This system has survived two World Wars, the Great Depression, and cyclical years of droughts and floods. With major adjustments, the system should be able to continue as a strong financial lender to agriculture. It is needed more today under the present circumstances than at any time since the Great Depression of the 1930's.

As the system has grown, the structure has become so large that at times it is like a large caterpillar struggling to move forward, but having trouble with its body moving in synchronization.

I will not appear to qualify myself as able to articulate all the present problems facing the system. It is no secret, however, that many farmer-borrowers are dismayed by some practices the banks have instituted in the last few years. In particular, this year, they are concerned that the move toward centralization will lessen their control as farmer-owners of the system. Farmers and their cooperatives are understandably upset by recent events, including the increased loan costs experienced by the system. As the system tries to handle the massive losses of the district banks, outside investors have been less anxious to buy system securities and farmers are turning to insurance companies, commercial banks, and others for credit, as their loan rates are lower.

The support of its farmer-owners is crucial for the survival of the system. Their backing will be needed for any necessary structural changes to the system. With the rates for borrowing increasing daily due to loan losses, financially stressed farmers are feeling alienated from their very own cooperative banking system.

It is important to recognize that while the system provides one-third of the credit to farmers, it also provides two-thirds of the credit to agricultural cooperatives. It is vitally important to remember that servicing credit needs for cooperatives and farmers requires different areas of expertise and different flexibility. The banks for cooperatives have had the advantage of a one-tier structure, allowing it to respond more quickly to outside changes in the agricultural economy and cooperative business community. The system must act quickly to regroup as a more efficient organization and must take into account the various needs of its differentiated customer base.

As far back as 1933, the Government has intervened in times of acute financial distress in the agricultural community. By then, the Federal land banks had paid off their original Government capital. Congress appropriated new capital and provided various measures to enable the banks to take on the Congress-decreed job of saving hundreds of thousands of farmers from foreclosures. Congress also provided the capital to establish an Emergency Federal Farm Mortgage Corporation for risky loans, to help the land banks. It also capitalized the banks for cooperatives and the production credit associations. And still, the Government got all of its capital back.

The U.S. Government has promoted the stability of the Farm Credit System by increasing the amount of its capital through purchase of nonvoting stock, and sometimes by guarantees on farm loan bonds. While Government capital infusion may not be needed by the system at this time, it is important to realize that the system has met its objective of providing the lowest cost of financing available to its member-borrowers—as a private institution and, at times, in a close partnership with the Government.

Again, I remind you, the structure may need some major changes but the underlying concept of farmers and cooperatives as borrowers and lenders is sound as proved by 60 years of excellent service to agriculture, to cooperatives, and to the entire economy.

Lastly, while I have focused on the Farm Credit System, the National Cooperative Business Association and its members recognize that any plan developed during the next few months must encompass not only the system but all financial institutions with unhealthy agricultural loan portfolios.

We call on the Farm Credit System, Farmers Home Administration, independent banks, and other involved parties to work together to devise a plan that will allow them to continue providing credit to their borrowers.

We also urge Congress to address our deficit problem and to work with the administration to bring interest rates to a level that will keep farmers and agricultural marketing and supply cooperatives functioning and solvent.

The National Cooperative Business Association will support the best contingency proposal put forth in the next few months to secure the stability of the Farm Credit System. On behalf of our cooperative members, we urge your support of all efforts to ensure the continued goal of the Farm Credit System of providing low-cost financing to struggling farmers and their cooperative businesses.

Thank you very much.

[The prepared statement of Mr. Williams appears at the conclusion of the hearing.]

Mr. **Jones** of Tennessee. Thank you very much, Mr. Kohl, for a good statement. And I assure you, as I did Mr. Willis, your statement will be exposed to all the subcommittee members as well as anyone on the full committee who desires to see it. We appreciate your attendance and your testimony.

Mr. **Kohl**. Thank you very much.

Mr. **Jones** of Tennessee. Our next witness is Bobby Gray of the American Farmland Trust here in Washington, DC. Bob is a familiar figure to this subcommittee and to the full committee, as far as that goes. He was with a former member of the committee one time, and moved to greener grounds.

Bob, you have done a good job where you are, and we appreciate the fact that you could take the time to be with us today.

STATEMENT OF ROBERT J. GRAY, DIRECTOR, POLICY DEVELOPMENT, AMERICAN FARMLAND TRUST

Mr. **Gray**. Thank you very much, Mr. Chairman. I really appreciate the opportunity to testify this morning, and I would like to start out by reversing the accolades from the standpoint that I would like to really thank the members of this subcommittee for the leadership that you have shown in the area of conservation as far as the 1985 farm bill is concerned. I think I can speak for all the conservation groups, not only here in Washington but across the country, in telling you that we are extremely pleased with the conservation provisions in the farm bill. These are probably the most historic and widespread changes that have been made in conservation policy since the inception of the Soil Conservation Service in the 1930's. So we are extremely pleased with that; I would like to go on record in thanking you for your leadership, and the other members of this subcommittee, for doing the kind of work that you have done.

One of the things that I wanted to talk about this morning that we think is important in an ongoing effort to make sure that conservation is linked as much as possible to all elements of agricultural policy—we feel that this has been done very well in the farm bill by integrating the commodity programs with conservation, by bringing the conservation reserve into the farm bill, and providing farmers with an opportunity to retire some of that highly-erodible land. Also, the sodbuster and swampbuster provisions are additional methods to tie the commodity programs with conservation.

But as we look at credit, and as we realize very, very clearly in going around the country and talking with farmers and meeting with farm organizations, that there is no question that farmers are in a very, very severe economic crisis and the financial situation is a very difficult one for many of our farmers in this country.

Our purpose, though, in looking at possible links between conservation and finances with farmers and the farming community is not at all to do any more damage or cause any more problems or any more hardships on farmers than they already have. But what we would like to do is think of some creative ways—if you take up a credit bill, and I'm sure that that's going to be your next item of business; you're going to be looking at ways that you can shore up either the Farm Credit System or the Farmers Home Administration, improve the credit situation out there—but if we could take some time at this period and look at some of the ideas that might work with working conservation and credit hand in hand, I think it would be extremely useful. I'd like to bring up just a couple or three points in that regard.

As you know, Congressman Franklin introduced a provision in the farm bill, and a very similar provision was placed in the Senate portion of the farm bill, that allowed farmers the opportunity—that had high debts—to give conservation easements on certain highly erodible lands or wetlands that would reduce their overall mortgage and would replace that land, get that land back into a conserving use. We think that is a pretty good idea; it is an idea that needs more work, because it is not entirely clear in many instances how much, for example, a conservation easement—a cropping right, you might say—might be worth on some of this land.

There is some work being done right now in Iowa and in Missouri, at the University of Missouri, and the Iowa Natural Heritage Foundation, a private nonprofit group in Iowa, has also done some work on this, and we think that there are some possibilities with this; because as you know, Mr. Chairman, there is going to be 25 or 30 million acres placed in the conservation reserve. But in addition to that, we're going to be looking at anywhere between another 25 and 40 million more acres of highly erodible land. And if conservation easements could be used in conjunction with credit, we think that this is something that might help the farmers and also achieve additional conservation items in agriculture and in the country.

In addition to the conservation easement idea, a number of times the idea has also been raised about working conservation plans and systems in with the credit institutions. I think that this has some merit; it was raised a couple of years ago by Congressman Evans from Iowa, who felt that maybe the Farm Credit System should look at conservation plans when they were discussing loan applications with farmers. And it has been talked about in terms of the Farmers Home Administration; in fact, some legislation has been passed linking that.

That is sort of a cumbersome approach, but there may be some additional things that we can do to ensure that farmers do look for conservation as they are working with a credit institution.

One of the interesting things that we noted—as you remember, Mr. Chairman—a couple of years ago we interviewed over 700 farmers, 1-hour, in-depth interviews with them, and this was during a time when prices were certainly low and their costs were very high; it was very similar to the situation we're in now. They were just starting into that very difficult time that they've been in for the last 3 or 4 years. But we discussed with many farmers, including a number in western Tennessee and Illinois and Iowa and Colorado, and in Wisconsin, we discussed with them the idea of conservation plans and whether or not they felt that conservation actually paid for itself. And almost unanimously—it was really surprising how many of these farmers told us that conservation, good conservation, pays for itself in the long run. But as we know, the difficult problem right now is getting enough money in the hands of farmers so that they can operate.

But we think there are some additional links here. We'd like to see them looked at, and we'd like to see them considered as this subcommittee moves along to look at a possible credit bill in the next few weeks. And my purpose in coming up here this morning was to sort of discuss some of these issues. We are going to be looking at them ourselves; we are going to be working with the other conservation groups. We wanted to let you know that that's what we were doing. We will be coming back to you with some additional ideas, and we hope that we can work together with this subcommittee and with your staff and maybe we can find some of these creative ways of linking conservation and credit.

And I want to thank you for the opportunity to testify this morning.

[The prepared statement of Mr. Gray appears at the conclusion of the hearing.]

Mr. **Jones** of Tennessee. Thank you very much, Bob, and I can assure you that your entire statement will become a part of the record although you summarized, and we appreciate that very much. May I say again that we do appreciate the good work that you have done for conservation and the cooperative effort that you have put forth with this subcommittee and the Farmland Trust.

Mr. **Gray**. Thank you.

Mr. **Jones** of Tennessee. Our final witness on panel No. 1, Mr. Fred Huenfeld of the National Organization for Raw Materials, Monroe, LA.

Mr. Huenfeld, we are delighted that you are here. We are pleased that you could spend the time to be with us, and you may proceed.

STATEMENT OF FRED HUENFELD, PRESIDENT, NATIONAL ORGANIZATION FOR RAW MATERIALS

Mr. HUENFELD. Thank you very much, Mr. Chairman.

Gentlemen, let me share with you 10 seconds, where I come from. I am a cotton farmer; I do legal work as trustee in bankruptcy. My business is fantastic as a bankruptcy trustee. I'm also in the real estate business. I guess I'm an agriculturist; I make more money off the farm than I do on the farm.

I'm the president of the National Organization for Raw Materials. This is an economic think tank, internationally, that convinced Roosevelt in 1942 to mobilize the economy with fiscal policy, the same fiscal policy that this button on my lapel—that my forefathers fought the American Revolutionary War over, the right to own and operate a business in a competitive system for profit with Government interference only to the extent to protect the public, and have a balanced national economy. It's called private enterprise, free enterprise. It's not free trade market-oriented agriculture, which causes absolute collapse, if you want to live in a mud hut and walk to work, and that's what happens in those areas that do that.

I just returned from Canada and visited with a young Canadian who was in Germany, trying to sell navy beans. Mr. Chairman, he was beat $100 a ton by Ethiopia, who had to pay their debt to the IMF, so they sold their navy beans at $100 a ton less than the Canadian could. And their people starve to death in Ethiopia.

The same thing is happening in every foreign country. Brazil sold soybeans for $3 a bushel to their farmers last year to service debt to the IMF, and we don't recognize the problem.

Now, gentlemen, I want to share with you briefly a perception that we—when I say "we," a number of farmers and businessmen around the United States—understand. It's called the American system of political economy that regulates the value of its money within its own economic system, just like each $1 of you do as a businessman with your personal checking account. You balance it. When we had this fiscal policy from 1813 to 1914 in America, $1 bought the same amount of food for 100 years. Abraham Lincoln understood it; that's why he said, "If England builds the rails, they've got the money, and we got the rails. But if we build the rails, we've got the money and the rails." In 1914 this Nation had zero public debt because of fiscal policy. In 1914, we changed that fiscal policy; by 1920, we owed $50 billion. By 1942, we owed $350 billion. At the end of World War II, which had balanced budgets in the United States for a 10-year period, from 1942 to 1952, we virtually paid for the war with no taxes and with savings from the American people because we monetized the renewable wealth. We structured our fiscal policy on the true value of the natural resources, Mr. Chairman; nature credits and man debits. You don't pay God back what comes from the land. You find this nugget of gold and you take it to the bank and you get a dollar bill as a medium of exchange, and that's all money is. But that pound of cotton or that bushel of soybeans or wheat, if you take it to the bank and you sell it for half what it cost you to produce, you are debt-financing the total system.

Now, NORM studied the Presidents' reports on economics since records were kept, Mr. Chairman. And we analyzed and concluded the following statement. Every $1 of net wealth that comes from the land creates $7 in the economy. But if you debt finance at the base level, you debt finance through the entire system.

Now, we changed that fiscal policy in 1952. We went on sliding price supports to renewable wealth. We went from $550 billion to $8 trillion in debt to date; that's just the known debt and we really think it's higher than that because we're committed to the Eurodollar, and we've got $8 trillion of uncommitted funds in retirements and Social Security. I don't have to tell you; you gentlemen know that.

But we can't pay those debts, gentlemen. So we're left with three options. You either recognize the missing link—and I blame myself for not sharing this with some of you sooner; I don't blame any of you—but you recognize the missing link, agriculture, because that's where it all starts. You get up in the morning and you eat and you put on clothes and you go into a building; that's called agriculture. Either you recognize the missing link, or you're going to have to collapse the economy. You can't pay the $8 trillion of public and private debt under the current structure of your fiscal policy.

Now, NORM concluded that every $1 dollar of agricultural income equaled $1 in labor and wages. That's based on the President's report on economics since records were kept in the United States. Every year, that was a parallel. Now, follow the scenario. The lower the agricultural income, the less money is earned in labor and wages. What happens? The lower money is earned in labor and wages—you create an aid to dependent children, the food stamps, unemployment compensation—some 1,600 welfare programs have been created since the 1950's to take care of the debt in the system that would be taken care of with earned income if you structured your fiscal policy on the true value of your renewable wealth. Nature credits; man debits.

As a businessman who runs a corporation, you debit and you credit. As a small grocery store, you debit and you credit. As a farmer, you debit and credit. But when you sell at half your cost of production, the total system debt finances at 50 percent of parity, times 50 percent of your land in production—you have 25 percent earned income in the system and 75 percent debt. Is it any wonder we went in debt $1.2 trillion last year as a nation? We had to borrow that money to take care of the services and goods of this society.

We have with you a document that's based on the economic indicators of the United States in the President's report on economics. This document shows that when we structured the fiscal policy in 1942 with the Steagall amendment, 6.9 cents or 7 cents out of $1 was the net earned income of the American farmer. Last year, he got one-half of 1 cent. The banks at that time were loaning out 16.9 cents, or 17 cents, out of the dollar; today the banks, according to the Federal Reserve report that's attached, ladies and gentlemen, loaned out $1.15 for every $1 that's on deposit. That's the loan- and investment-to-deposit ratio.

Now, either as leaders we address the issue or we have to answer the following questions. If you don't want to recognize the missing link, then collapse the economy. And when you collapse the economy and reorganize it, please study what we did as a Republic. When we set it up we regulated the value of our money. We did it from 1813 to 1914.

You only need three policies, Mr. Chairman: parity price and renewable wealth, fair weights and measures, and equity of trade between nations. You are Peru; I'm the United States. You have tin and I have wheat, but my standard of living is—I live in a nice house and I drive to work and I have a good standard of living. It costs me $250 a ton to produce that wheat because I have to take care of all those sectors of my society, and that's part of the cost of production. You have tin; I pay you for your tin based on what it would cost me to produce it in the United States, Mr. Chairman, and then I have equity of trade, fair trade, honest trade—that's all we're talking about. When you have fair trade, I raise your standard of living.

If you read the book, what Roosevelt said right at the end of the war when he spoke to Churchill, he said, "We just defeated Germany, a slave nation. To raise the standard of living of people we cannot return to the imperialistic, colonialistic system of the 19th century." And yet, we've allowed it to happen by pegging the base of our society on the true value of our renewable wealth. We are not getting it. Nature credits; man debits. You don't pay God back what comes from the land. And every laborer is worth his hire, and the first laborer is the tiller of the soil. That's where it all starts. Plato understood that; he put it in The Republic. That's what he said, if you read his works. That's what Washington and Hamilton understood, and they put it in the Constitution of the United States, under article I, subsection 5, section A of the Constitution. It says, "To have a par economy for prosperity, you regulate the value of your money within your own system."

Now, if you study this President's report on economics where we tracked it, and you see where we are today with our economic system loaning out $1.15 for every $1 that's on deposit, we don't have much time, Mr. Chairman. And I leave with the following comment, and I want Mr. Stenholm to hear this.

Every laborer is worth his hire, and the first laborer is the tiller of the soil.

[The prepared statement of Mr. Huenfeld appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Huenfeld, for your statement. And although I believe that you summarized, your statement will be made a part of the record.

At this time, before I ask panel No. 2 to appear, I'd like to recognize the chairman of the full Agriculture Committee, who has devoted a lot of time, to this subject, who is intensely interested in what we're trying to do and gravely concerned about the problems of farm credit today.

Mr. de la Garza, I appreciate more than you know the fact that you would come this morning, as you did yesterday, and I'd like to yield to you.

The **Chairman**. Thank you, Mr. Chairman. I don't have anything to add. I appreciate the witnesses being here, and those on the second panel, and the work that the subcommittee will do will be of great importance to the future of this Nation and your contribution, I assure you, will be an asset to us. And I thank you, the chairman of the subcommittee and the members of the subcommittee, for the dedication in this effort.

Mr. **Jones** of Tennessee. Thank you very much, Mr. Chairman.

I think that we have the time this morning for some questions for this panel, and I'd like to yield to those who were here earlier; and then the other members of the subcommittee who are here now, and although Mr. Madigan has left, I'd like to recognize Mr. Lane Evans for any question that he might have.

Mr. **Evans** of Illinois. No questions.

Mr. **Jones** of Tennessee. And then, to Mr. Stallings for any questions he might have.

Mr. **Stallings**. I'll pass, Mr. Chairman.

Mr. **Jones** of Tennessee. Mr. Thomas.

Mr. **Thomas**. Mr. Chairman, just a comment that I think ran pretty much to a statement of members of the panel here. I think it's very important, and that is the fact that as we've watched this continued deterioration of the agricultural economy, we need to be very much aware that it, in turn, translates into a—certainly, a deterioration of the very base that we farm from, and that's the land itself. And I think this panel made that loud and clear. That's what we literally have done; we're spending a natural resource. We're not rebuilding it; we're not taking care of it; we can't afford to under these economic conditions. And that leads us toward some sort of a real rendezvous with destiny down the line when we find that our land and its fertility has been totally depleted. That's what this is bringing in real terms to the land, and I'm just glad this panel realizes it and made those comments.

Mr. **Jones** of Tennessee. Thank you, Lindsay.

To Sid Morrison for any questions he might have.

Mr. **Morrison**. Thank you, Mr. Chairman.

I would like, first of all, to thank all the members of the panel for their presentations. I think Mr. Huenfeld was just getting warmed up.

I was wondering—I think this committee probably would accept your theory of the missing link, and that is that strong agriculture is paramount to maintaining the strong economy in this Nation. I wonder if you would maybe give us the missing link from your presentation—perhaps you didn't have time to give it—that is, we got a good recitation of the problem as you see it, which may be a little different than the view of others. But what's the answer, and how do we get there from where we are today?

Mr. **Huenfeld**. Thank you very much, Congressman.

NORM took the President's report on economics since records were kept and analyzed the scenario that I recently went over with you—that every $1 of agricultural income creates $7 in the multifactor. And every $1 of agriculture equaled $1 in labor and wages. So I followed that scenario.

Now, if you will analyze this back sheet, and attached to it is a complete documentary—what I call the real story, which is based on the economic indicators published by the Department of Commerce for the Joint Economic Committee for Congress—given a complete report on the Federal Reserve System in the United States, which is attached, showing their loans and securities as to their deposit ratio as of February 27, 1985; and when you divide the loan and securities by the deposits, you find you've got $1.15 loaned out for every dollar that's on deposit.

Now, there's only one answer, Mr. Chairman. You have to understand what a republic is. You regulate the value of your money. Now, what is money? Money is only a medium of exchange for that nugget of gold. Now, each businessman in his business debits and credits. Agriculture debits and credits, but nature credits, so you don't pay back what comes from the land. That's earned income. It costs something to produce it, but you have to get the true value of that cost of production or you don't translate earned income in the system. We proved it mathematically. We proved it mathematically. You have to monetize your renewable wealth; say it another way, you have to get the true value of your cost of production at a reasonable return; say it another way, you have to get parity for what you produce. Price times production equals earned income; that's a truism. I mean, 50 percent of parity and 50 percent of land in production, the PIK, only gave us 25 percent earned income, 75 percent debt. That's why we went $1.2 trillion of additional debt last year, because we didn't have the earned income in the system.

Now, you only do it one way: with fiscal policy, structure the base by getting true value of agriculture. You do it with legislation. The Secretary of Agriculture has the authority to do it now; of course, he won't do it, but you can demand it. When you do that, that's the missing link. You have to get the true value at the base level.

You've got to understand, the law of supply and demand and the invisible hand of the market only says to the chairman and the Congressman that you believe in pain and pleasure and have no control over your destiny. And as Christians, we don't believe that. It should be the law of demand and supply; demand comes first, supply follows. What's the first thing you——

Mr. MORRISON. Let me ask the question, then, how do you get prices back to a parity level? Do you borrow more money?

Mr. HUENFELD. That's not solving the problem. You don't borrow money. You structure your fiscal policies so that the marketplace pays the true value based on the cost of production. You parity-price your renewable wealth. You have to put parity on agricultural commodities. When we did it, in 1942 to 1952, the American farmer averaged 107 percent of parity. We literally produced so much and we had so much earned income that we had to import commodities to meet our demands. Now you're told there's a surplus. There's no surplus. There's a lack of earned income to purchase what you produce.

Mr. MORRISON. OK. Thank you. I'm not sure I have my working answer which this subcommittee needs, but——

Mr. HUENFELD. OK, as you read this real story, it gives it to you in detail, Mr. Congressman.

Mr. MORRISON. OK.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Sid, for your questions.

And now to Mr. Tallon for any questions he might ask of the panel.

Mr. TALLON. Thank you, Mr. Chairman, and I thank the panel for being here. I'm sorry I'm a little late.

Mr. Huenfeld, I've been reading your testimony and I apologize, but please explain to me what we did between 1942 and 1952 that you advocate we go back to.

Mr. HUENFELD. I'd be glad to.

Let me give you about one second of history. In 1933 a man by the name of Carl Wilkins started a study on the President's report on economics. He went back as far as records were kept, and he found the relationship that I shared with you just a moment ago. In 1942, the Steagall amendment was attached to the Senate Banking Committee that put 90 percent of parity on agriculture commodities. The five basic commodities are all you have to do: cotton, corn, soybeans, wheat, and milo. They structured it to where 90 percent of parity was the minimum price that those crops would sell for.

As a result of that fiscal policy, the farmers averaged getting 107 percent of parity over that period. When we did that, we had enough earned income that we doubled the personal savings in America in 1 year. We had so much money in the bank, the banks were only loaning out 17 cents out of the dollar. We had enough money that the war was paid for by our own earnings because we were functioning as a republic. We were getting the true value at the base. Nature credits; man debits. That's where it all starts.

Now, let me dialog with you where you are in the structure today. You have agriculture, you have corporations, you have small businesses, you have rent income, you have labor and wages and interest. That's six sectors of any society in the world. Today, in a 100-yard dash, in a 10-second race, the interest income is on the 10,250 yard line when you start the race, plus 14 for labor, minus 30 for rent, minus 50 for small businesses, minus 54 for corporations, and a minus 97 percent for agriculture. All you have to do is get your fiscal policy in order with 90 percent of parity. You automatically get the true value of agriculture. Then you create the earned income in the system instead of debt. You're creating debt because you aren't getting the true value at the base level. It all starts there.

Mr. TALLON. What changed in 1952?

Mr. HUENFELD. We changed the fiscal policy by going to sliding price supports on agriculture. We took off the 90 percent of parity, and we let the free traders get control of the governmental system; and they advocated sliding price supports. And we started lowering the price supports because we've got to compete.

Let me tell you, you are looking at a nation that has Canada, South America, Germany, and Italy ready to join us in parity pricing. I've been to Germany; I've spoken in 100 different places in

Germany and Italy. I've been to Canada. I've spoken to 17 different organizations in Canada. I've been with the chairman of the Agriculture Committee from Argentina, with representatives from Brazil, Mexico, Bolivia. And these foreign countries, they want us to parity price because you raise the standard of living of people when you get the true value at the base level. If you want to wear loin cloths, if you want to live in a mud hut and walk to work, then free trade, because that's colonialism. That's serfdom. That's socialism. That's communism. That's totalitarianism. It's all the same thing. And then you've got the American system. There's only two economic systems in the world: A republic, which is the American system that we taught Japan in 1868, that we gave back to them in 1945, that they are practicing today. We aren't. We ought to be friends with these people. The Japanese are using our system. We taught them. They're just smarter than we are.

Mr. TALLON. Thank you very much.

Mr. Chairman, I yield back my time.

Mr. JONES of Tennessee. Thank you very much, Mr. Tallon.

And now I yield to Mr. Stenholm for any questions he might have of the panel.

Mr. STENHOLM. I have no questions.

Mr. JONES of Tennessee. Thank you, Mr. Stenholm.

I have one question I'd like to ask Tommy Willis. For the sake of time, I'm not going any further than that.

In your testimony, Tommy, you without a doubt oppose a bailout of the Farm Credit System, at least until a farm bill is written which shows some prospect of improved farm income. Now, it may be a little bit early for you to comment in detail, but I wonder if you have any thoughts about the farm bill which the Agriculture Committee reported out last Tuesday evening?

Mr. WILLIS. As reported out, we support the farm bill because, basically, of the referendum provision which was in there. It was offered by Mr. Bedell. We feel like this approach could provide a profit for agriculture. There are some things we'd like to change in there that we don't agree with 100 percent, but basically it's a good philosophy and we support that position.

Hopefully, this will pass and we'll have no problem with the Farm Credit System. Now, we know that the Farm Credit System needs some help; we admit that. But we've seen so many bank bailouts that have meant nothing to agriculture, and a lot of them have been false bailouts—as I mentioned, some of the loans that have been made, the FmHA, SBA, made in the name of farmers when actually they were bank bailouts. And until we solve the problem where a farmer can cash-flow his operation, it's not going to do any good very long to try to bail out the bank because it would be a short time—I've heard different figures floated around; anywhere from $5 billion to $20 billion it would take to bail the banks out. I don't know what that figure is, but regardless of what it is if we don't put a profit back in agriculture and do it quick, it will not be enough money. In other words, we'll be back up here next year or the year after, appropriating more money for another bank bailout. It's just that simple.

Mr. JONES of Tennessee. Then are you saying that you would support the farm bill as was reported out—the farm credit bailout, if the farm bill is reported out and signed by the President as this committee reported it?

Mr. WILLIS. Yes, sir, along those concepts. There are some things in the farm bill—for example, Mr. Bedell's referendum only affects, I believe, wheat and feed grains, if I'm correct. And we'd like to see that expanded to cotton, soybeans, some other commodities.

Mr. JONES of Tennessee. Thank you very much, Tommy.

Well, we've got a little time. Let me cover this quickly. I'll ask the panel to be brief, and I'm going to refer to anyone who wants to answer.

Some people say that agricultural credit has been too easy, and that it also has been too plentiful for the past good many years. They also say that lenders were too anxious to extend credit without being careful to make sound judgments about borrowers' ability to repay, and farmers were too anxious to borrow more money without making sound judgments whether they could service their debts or not. I'd be interested in any comment that any of the panel has, being as brief as possible, being faced with the problem that we have over at the floor right now. Anyone who wants to respond.

Mr. HUENFELD. I'd like to respond to that, Mr. Congressman. Let me share with you the point I was going to bring up earlier.

There are only two economic systems in the world: The American system of political economy that regulates the value of its money and gets the true value at the base level when you have the correct fiscal policy, and the other system is called an oligarchy system, or free trade. And under that system you have two groups that are one of the groups that you just mentioned, called the conservative group that says, "The man's a slob; he's a bad businessman; he's not a good businessman," so that group pits against the liberal group that says, "We need to take care of people." The bottom line is that both of these groups are free traders. They are the ones that are causing the problems. You can't sell your renewable wealth below the cost of production, Mr. Chairman. No system in the history of 14 known civilizations in mankind has ever done it. Every civilization you study, you're going to find they collapse when they become a service and goods society. We are a production Nation, and the production sector of society has to have earned income. And you do that with fiscal policy. You structure fiscal policy so that it does it at the base.

Now, true, some men are going to run around and they're going to get drunk and they're going to be bad businessmen, and some aren't; that happens. But the thoughts that you projected are typical of those who say, "He's a bad businessman because he doesn't take care of his farm; he doesn't stay there; he's in Washington all the time." They say the same thing about me. But the proof of the matter is, you can't sell your natural resources below the cost of production, and a republic wasn't organized to do that, sell below the cost of production. You've got to structure the fiscal policy to get the true value at the base level. Statistically, we proved it. Our forefathers had enough forethought to understand that when they put up the Constitution of the United States with that correct fiscal policy. And we've got to be smart enough to understand what they were talking about. That's our challenge today.

Mr. JONES of Tennessee. Thank you, Mr. Huenfeld.

Anyone else.

Mr. GRAY. Mr. Chairman, I'd just like to make a comment to Mr. Willis.

Mr. JONES of Tennessee. Go ahead.

Mr. GRAY. I don't think that, in looking at the figures and talking with the farmers that we have talked to, most of them at the time, I think, made sound business judgments in terms of borrowing more money in the 1970's when our exports were increasing. Their debt-to-asset ratio was good. But, of course, in those areas of the country—particularly in the Farm Belt, the Corn Belt area—where you've had this dramatic drop in land prices, that has just cut that whole equity figure out, and that's what's really, really got many of them in a bind in terms of where they are, how much more they can borrow.

It's interesting to note—I noticed in the paper yesterday that the Farm Credit System in the Baltimore area is going to have a surplus this year. They're going to turn a profit. And as you look at the land prices, because I've been involved in Howard Country, MD with the Purchase of Development Rights Program for farmers in the State of Maryland—it has a program that pays the farmers the difference between agricultural value of the land and the fair market value, if a farmer is interested in selling their development rights out. But we noticed that the land prices in Maryland only dropped about 5 to 10 percent, and that's true in many of the regions of the country. And of course, that is why some of them, many of the farmers, are in a little bit better economic condition because of that. But I don't think that those farmers at that time, given the information that they had, made poor business decisions at all.

Mr. JONES of Tennessee. Thank you, Bob.

Mr. Willis, right quickly.

Mr. WILLIS. I agree with Mr. Gray to a large degree there, and that was kind of what I had in mind saying.

At the time the loans were made, they were good loans; because you can always look at isolated cases and see loans that shouldn't have been made, or farmers that shouldn't have tried to borrow the money from either the banker's standpoint or the farmer's standpoint, either one. So there are always isolated cases.

If we really want to be critical and look back over the past and say, "Where was the mistake made," it is difficult to say where the mistake was made so far as one single instance is concerned. But I think one mistake that we made, though, was—you know, a few years ago, not too many years ago, the Farm Credit System, for example, loaned about 65 percent of the appraised value of the land. That has been continually raised up until it is, what, 97 percent today. This was a mistake, but now we can look back and see it. At the time, it probably wasn't, or we didn't think it was, anyway.

Mr. JONES of Tennessee. Thank you very much, gentlemen.

Will panel No. 2 appear at the witness table while we are gone to vote? And the subcommittee will stand in recess for about 15 minutes.

[Recess taken.]

Mr. JONES of Tennessee. The subcommittee will resume its sitting.

Panel No. 2 is at the witness table, and I yield to one of the members of the subcommittee, a very valuable member, Mr. Richard Stallings of the State of Idaho, for the purposes of an introduction.

Mr. STALLINGS. Thank you, Mr. Chairman. It is my pleasure to introduce a personal friend and president and general manager of the Eastern Idaho Production Credit Association, Mr. Elden Hill. Elden is accompanied today by Mr. Lafe Holbrook, vice-chairman of the board of directors and a county commissioner of Caribou County, which is a predominantly agricultural county in the southern end of my district and Mr. John Hansen, legal counsel for the Eastern Idaho PCA.

I believe Mr. Hill's testimony today will be particularly relevant to this subcommittee's deliberation on financial assistance for the farm credit system. The Eastern Idaho PCA is part of the Spokane Federal Intermediate Credit Bank which has, over the past 2 years, experienced financial hardships and the liquidation of eight production credit associations in their five-State service territory. By now, the Spokane financial assistance plan, requiring the infusion of more than $136 million from the other 36 farm credit banks has become quite well known; not only for its early signs of stress in the Farm Credit System, but also for its solution to this crisis—namely, the merger of all district PCA's and Federal land banks into one super PCA and Federal land bank.

I believe Mr. Hill can share with us his PCA's experiences with this trend in pooling resources and centralizing management at the district level and away from the grassroots farmer/borrower level, which has traditionally made the Farm Credit System so very strong.

Elden, if you'd go ahead.

STATEMENT OF J. ELDEN HILL, PRESIDENT AND GENERAL MANAGER, EASTERN IDAHO PRODUCTION CREDIT ASSOCIATION, ACCOMPANIED BY LAFE HOLBROOK, VICE CHAIRMAN, BOARD OF DIRECTORS, AND JOHN HANSEN, LEGAL COUNSEL

Mr. HILL. Thank you. Thank you, Mr. Chairman, and Mr. Stallings.

Mr. JONES of Tennessee. Mr. Hill, before you begin let me say that we are delighted that you three gentlemen from the State of Idaho are here. I'd like to say that I appreciate more than you know the fact that John Hansen is here; I'd like to relate to the subcommittee that John is a brother to a former Congressman, Orville Hansen, who served in this body for a good many years and who was a distinguished member of this body and a gentleman that I have the utmost respect for.

With that, Mr. Hill, you may proceed.

Mr. HILL. Thank you.

The Southern Idaho Production Credit Association is headquartered at Pocatello, ID, and part of the 12th Farm Credit District of Spokane, WA. The territory served by Southern Idaho Production Credit Association encompasses the eastern and southern portions of Idaho, and also a portion of western Wyoming. EIPCA was chartered on January 6, 1934, under the Farm Credit Act of 1933 and has operated as a farm lender for over 50 years. I have served the association continuously for over 34 years, and I've served on several task forces, several different district advisory committees. We are one of the largest associations, both geographically and in terms of loan volume and capital assets.

Our association has long been and is now a strong supporter of the Farm Credit System, and well aware of the seriousness of the financial problems facing not only the district, but the entire Farm Credit System. We desire to work to strengthen and improve the system.

Financial stress is not new to us. The association experienced a substantial single-loan loss over a decade ago, and in 1975 activated the Mutual Loss Sharing Program and received approximately $1.4 million in loss-share money, which was later paid in full. In recent years, eastern Idaho contributed approximately $350,000 to two associations which later went into liquidation, none of which has been or will be repaid.

Serious financial difficulties in the 12th District FICB became evident and major district-level management changes were made in the summer of 1983. Before year end, four PCA's were placed in liquidation, including Southern Idaho Production Credit Association. At the request and urging of the 12th District FICB in December 1983 we acquired the assets of Southern Idaho PCA and expanded our operation to encompass the territory formerly served by Southern Idaho. As a result, we have acquired considerable firsthand knowledge and experience with the overall impact that rapid expansion and personnel, policy and other management changes have on borrower/members, and the resulting loss of loan volume.

In late 1984 a proposal was presented to the 12th District PCA's for consolidating the remaining 26 associations into a 9-PCA configuration, which the district felt would result in more efficient operations. The recently expanded territory of EIPCA would have constituted one of the nine associations. The proposal was acceptable to the PCA's; however, it was rejected by the FCA. FCA determined that the financial condition of the district had deteriorated such that an infusion of substantial capital was necessary. By year end 1984, another four PCA's were placed in liquidation. A plan was devised to merge all PCA's into a single, districtwide super PCA, and all Federal land bank associations into a districtwide super Federal land bank association.

Following a study of the plan of merger, we could not recommend that our stockholders vote for a single super association. The directors felt that the merger plan did not address the problems and the needs of the FICB and the PCA's of the district, would cause needless disruption to efficient and viable associations and ultimate loss of needed loan volume, and if used as a model by the other districts, such a plan would subject the Farm Credit System to serious jeopardy from greater losses. Also, we were concerned that the merger plan was legally flawed, and that the proposed financial assistance plan was inadequate and would likely add additional financial stress to the district. Our views were and are similar to the views expressed by the Idaho congressional delegation in the letter attached to exhibit 2 to our written testimony.

The merger plan was submitted to our shareholders in late June and early July 1985. Our stockholders rejected the proposal, with over 50 percent of the stockholders voting, and over 81 percent of those opposing the super PCA.

In early August 1985 the board of directors of the 12th District FICB adopted a resolution approving an amended plan of merger, which has since been submitted to the stockholders of 21 PCA's in the district, excluding the stockholders of our association. The amended plan, which is being vigorously pursued, is similar to the plan earlier presented to and rejected by Eastern Idaho. However, it contains the features which are of great concern to Eastern Idaho PCA. The amended plan would again create a single super association, but not just including the territory of those PCA's voting on the plan, but also include the entire territory served by Eastern Idaho.

Exhibit 11, consisting of a letter dated August 30, 1985, to FCA Gov. Don Wilkinson in response to an invitation to detail our legal and policy concerns, outlines the main thrust of our present position.

Recent announcements from the Farm Credit Administration bear out our earlier concerns, that the financial crisis facing American agriculture was much greater than projected when the merger plans were formulated. The amended plan has even greater potential for harm; not only to Eastern Idaho, but the 12th district.

EIPCA respects the right of other associations to pursue a voluntary merger, and the likely benefit to some associations. We submit, however, that the revised plan which would allow all remaining PCA's to merge with districtwide territory completely overlapping our chartered territory "so that it will compete with Eastern Idaho PCA" reflects a concept totally foreign to the intent of the Farm Credit Act and regulations.

We must vigorously oppose implementation of such a plan of a head-to-head competition. Territorial overlap can only lead to greater financial stress, not only to Eastern Idaho but also to other associations. This seems an astonishing solution to problems involving severe financial weaknesses in the 12th district.

We recognize the extreme seriousness of the present credit crisis, and quite frankly, anticipated the need for financial assistance from the Federal Government while looking to the system's own resources and reserves to the maximum extent possible. This must be done, however, in a manner that ensures that individual associations are not only able to survive, but to operate efficiently and competitively with commercial lending institutions.

The organizational changes proposed in the 12th district with respect to the overlap would serve no useful purpose. The main stated purpose for the overlap is to provide one-stop credit service throughout the entire district. Eastern Idaho has repeatedly expressed its commitment to one-stop credit and pledged willingness to cooperate in its implementation immediately in five Idaho cities in which offices are located, and to work fo implement one-stop service throughout the rest of our chartered territory.

Given the dramatic announcement from Governor Wilkinson last week, undoubtedly Congress will soon be called upon to consider a financial assistance plan for the ailing Farm Credit System. Congress must properly insist on control measures to ensure that this system utilizes its own resources to the maximum extent possible to minimize the assistance dollars needed.

Root causes of the present dilemma should be carefully examined so that legislative action taken reflects positive and constructive steps to stabilize and improve the system long term, and avoid hastily conceived and unnecessarily radical changes.

The present financial crisis facing the Farm Credit System is not the result of major defects in the organizational structure of the system. The system has served American agriculture well for over 50 years during prosperous times, as well as times of depression. The strength of the system has resulted from the fundamental concept of separately chartered associations with grassroots input and local control, with proper and constructive supervision from the district, and Farm Credit System levels. A highly centralized national farm bank will neither serve the best interests of or be supported by the majority of American farmers and ranchers.

Changes have occurred and will continue to occur, and will require a response to the challenges of a dynamic agriculture. We have a saying in Idaho: "If it breaks, fix it; if it works, leave it alone." In examining the various suggestions for revamping the Farm Credit System careful consideration must be given to the probable bottom line impact on the borrower/members.

Care should be taken to make certain that solutions address the real problems, including the lending excesses of the 1970's. Change is essential; outside capital must be obtained. Controls need to be imposed to ensure better management and supervision. Associations financially too weak or geographically too small to be viable operations must be merged. Loss share programs need to be revised to ensure the system can quickly utilize and maximize its own resources and reserves. Management functions must be consolidated wherever reasonably possible.

Change must occur in a manner that does not unnecessarily disrupt organized, efficient, and viable associations. Care must be taken to ensure retention of those features of the Farm Credit System which have been and are now serving the best interests of American agriculture. Changes must not occur in a manner disruptive to the American farmers and ranchers, who are the backbone of the Farm Credit System.

Often we ask ourselves, "Who owns the system?" The farmers and ranchers do.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Hill appears at the conclusion of the hearing.]

Mr. Jones of Tennessee. Thank you very much, Mr. Hill for a good statement.

Mr. Hansen, do you have a statement that you would like to add?

Mr. Hansen. No, I don't have a statement as such, Mr. Chairman. Thank you.

Mr. Jones of Tennessee. Mr. Holbrook, do you?

Mr. **Holbrook**. I could possibly make one comment as to the viability of agriculture, Mr. Chairman.

Mr. **Jones** of Tennessee. Please do.

Mr. **Holbrook**. It has been spoken of freely the last 2 days. We are all aware of the extreme distress; and the bottom line, of course, Mr. Chairman, is income.

In this situation, I see parallels. I see with agriculture, with the Farm Credit System, and with Government, and in each of these situations we're spending more than we're making. The only thing with agriculture is that we have a moral responsibility to pay that money back, and that is breaking our back and it's dragging—agriculture is dragging down rural America in this Nation.

I would suppose that my remarks might be a bit emotional, and I apologize for that, but if there isn't room for emotion in the plight that American agriculture is in today, then I would suggest that probably America does not any longer have a heart.

Thank you, sir.

Mr. **Jones** of Tennessee. Thank you very much, Mr. Holbrook. That's a very fine statement, and we appreciate it more than you know.

If you gentlemen will remain at the witness table now, we'll go to the next witness, Charlene Reiser, a PCA borrower of Valentine, NE.

Ms. Reiser, we appreciate you being here, and you may proceed.

STATEMENT OF CHARLENE REISER, RANCHER, VALENTINE, NE

Ms. **Reiser**. Thank you, Mr. Chairman.

I realize that times are changing, and I realize that we, as intelligent citizens of this country have to change with the times and try to better ourselves and our operations for the future. But there are some things that should stay the same throughout eternity and should not change. One of these things is honesty, trust and honesty between one another. When the time arrives that you cannot trust your banker, something is drastically wrong; and that wrong needs changed.

What I am speaking specifically about is the Valentine Production Credit—in liquidation—in Valentine, NE, which is in the eighth district.

My father and I are ranchers from south of Valentine. We live on the old homestead out by Brownlee. My father is 80 years old and has worked hard all his life. He retired when he turned 75 because of his eyesight. We bought some additional land 26 years ago in Thomas County, down by Thedford. It was nearly paid off until about 5 years ago, when conditions in the agricultural system and the economy sort of went to hell. High interest rates, cheap cattle, cheap grain, and high operating expenses—you all know the story. We changed over from a city bank approximately 8 years ago to PCA. Our major reason for doing so was because we thought it was supposed to be owned and operated by local farmers and ranchers who would participate in the management and the credit advice. We assumed that it would be better operated and understand the needs of the people in agriculture. We assumed wrong. They advised us that their interest rates were lower, or at least competitive, and that they were there to help us. Well, let me tell you something. Their kind of help isn't what we had in mind. It certainly was not honest or understanding.

We are ranchers whose newest tractor is 20 years old; our oldest, which we still used until they took it away, was 43. Our one and only pickup is going on 10 years old, so as you can tell, we weren't extravagant at all. We always tried to save our pennies and didn't buy anything we didn't need. With PCA's help we had 18 to 20 percent interest rates in the early 1980's, which ran off a good share of their best, solid borrowers. With cattle prices going down 5 straight years in a row, and noncompetitive interest rates, we've acquired a loss we will never recuperate from.

One of the most undermining tricks they pulled on us happened in April 1984. They sent us a letter, said, "come in for a visit." This particular visit was just me and my father. They told my father that he needed to pledge more security. They asked him if he would mortgage some land. He told them he would mortgage his south place in Thomas County, but he would not mortgage the old homestead in Cherry County. They said, "OK, we'll type it up; be back next week; come in and sign it."

The very next week we were still calving, so I stayed home. My father and stepmother went in by themselves.

Before we go any farther, I must tell you that my father is nearly totally deaf. He's deaf totally in one ear and only has 10 percent out of the other one. He is blind; he cannot read, pass a driver's test, see to watch television, or anything of that sort. He can see objects in front of him, but not well enough to tell men from women. Before this time, my father trusted his banker as a friend and as a business manager.

When he and my stepmother returned the following week to sign the necessary papers, he assumed the papers were written up as discussed the week before. He could not see what he was signing, and they knew it. As for my stepmother, she's a sweet little old lady who knows nothing about business. They just handed her the paper and said, "Here, sign here." She signed because my father did, and trusted everything was OK as was formerly discussed the week before.

Several months later, after hearing rumors about the PCA and some wrongdoings that had happened to other people, I decided to check it out. My findings were that the mortgage was not on the land in Thomas County, but it was on the homestead in Cherry County. When I presented my father with this fact, I asked him if he knew that he had signed the mortgage against the homestead, and he said, "No, I wouldn't do that." When I convinced him that he really had, he just couldn't believe it. He said, "This is not the way it was supposed to be at all." Later on, one day in town, I stopped in to see them at the PCA and asked them what the deal was. They said that the legal descriptions were easier to get for Cherry County, and all that they had to do was just go downtown.

If this procedure that PCA was doing is not illegal, deceitful and totally unscrupulous, then I must not know what is. From the very beginning when we discussed transferring our loan from the commercial bank to the Valentine PCA, if they would have informed us that there was any risk at all or any possibility at all in losing the B stock, we sure wouldn't have gotten a loan with them. Nobody in their right mind would. Would you?

By their mismanagement and their negligence, they have ruined us by closing and liquidating us.

We are not asking for a handout. All we are asking for is the release of the liability on our B stock. All summer of 1984, the rumors kept circulating on how the Valentine PCA was going to close. Every time we stopped in the office, we would ask if this was true; they always said, "No, oh, no, we're doing fine; we're in great shape." By coincidence, just the day before, before they officially announced the closing on the radio, we happened to be in town. We stopped by, asked them the very same question, and got the very same reply as before.

Lies—where was their fiduciary responsibility? They signed that security agreement, too. PCA should have never put us in jeopardy in the first place, and why weren't the directors working for us?

During the last several years before they closed, they advised us to go to a yearling operation. They told us to buy 300 yearling steers for the summer instead of taking them in by the month, like we usually do. We lost $30,000 on this deal. I call this negligent advice. They wouldn't listen to our deal that we had penciled out on paper. Are these people supposed to be specialists in farm credit?

We feel deceived, manipulated by not being informed of the risk of the B stock. We assumed that we owned it, from what they said. We were given bad advice which caused us damages. We were not informed of the serious financial shape that our association was in. We were lied to about the closing, right up to the very last day before it was announced. They were dishonest and led a blind man, causing him to sign a mortgage on different property than what he consented to.

Mr. JONES of Tennessee. Ms. Reiser, will you allow me to intercede for just a moment? We have a vote on the floor of the House, and we have only about 7 minutes left to go vote. We'll take up where you just finished when we return.

The subcommittee will stand in recess for about 15 minutes.

[Recess taken.]

Mr. JONES of Tennessee. The subcommittee will resume its sitting.

Ms. Reiser, I apologize to you again for breaking in on your testimony, but it is important that we hear it all, and I thought that was the opportune time to do so because we just barely had enough time to go get the vote in. So, if you will go ahead and proceed from where you left off, please.

Ms. REISER. During the last several years before they closed, PCA advised us to go to a yearling operation. They told us to buy 300 head of yearling steers for the summer instead of taking them in by the month like we usually did. We lost $30,000 on the deal. I call this negligent advice. They wouldn't listen to our deal that we had penciled out on paper. Are these people supposed to be specialists in farm credit?

We feel deceived and manipulated by not being informed of the risk of the B stock. We were given bad advice which caused us damages. We were not informed of the serious financial shape that our association was in. We were lied to about the closing right up to the very last day before it was announced. They were dishonest and misled a blind man, causing him to sign a mortgage on different property than he consented to. They have a loss-sharing agreement which they have not stood by which, to me, is nonspecific performance. Their conduct has been less than legal.

To us, they are the ones that are poor managers. They were the ones that made several large loans that were not secured. They mismanaged our association and put us in financial trouble. We are getting nailed because of their mistakes. We did not receive a financial statement for 1983 or 1984. Then they yelled that they are bankrupt, closed their doors, and then tried to pressure the borrowers into paying back in 60 days what they borrowed over the last 10 years.

Let me ask you this: If you lived in the city and owned a home that was not paid off and your lender said to you that you have 60 days in which to pay off the total balance of your loan and, then, on top of that, raised your interest another 10 percent for the duration of the whole loan, could you pay it off in 60 days? Well, it is the same difference. How would you feel if you had to sell everything you worked for 60 years for and end up with nothing?

We have lost half of our land, all of our cattle, and all of our machinery from what we consider unauthorized liquidations. All we want is a release of the liability of the B stock which, by rights, should be ours anyway. That is the least that we deserve after all the wrong doing of the Valentine PCA and the Farm Credit System. We have had to tighten our belts before, couldn't always get the new shoes or the new clothes that you wanted, but I never thought we would see the day when we couldn't pay the electric bill or even be able to buy groceries, especially after doing an honest day's work.

So, we need a change all right, a change in the Farm Credit System. So, please help us. Please help us reorganize a system that will work and get a good farm bill that will bring us in some income so we can pay back our bankers.

Thank you, Mr. Chairman.

[The prepared statement of Ms. Reiser appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Ms. Reiser. We appreciate the fact that you are here. We regret that we have to sit here and listen to such a terrible story as you have there, but we know that is one of a number that is evident over the United States as far as the production credit associations and Farm Credit System is concerned, and we, too, on this committee are very much upset with the problems we have.

If you will remain where you are, we will hear the next witness and the final witness and then come back to the full group of the panel. The next witness is Mr. John Bush, a PCA borrower, also from Valentine, NE.

Mr. Bush, we are delighted that you could come and share your problems and feelings with this subcommittee. You may proceed.

STATEMENT OF JOHN BUSH, FARMER, VALENTINE, NE

Mr. BUSH. Thank you, Mr. Chairman.

Ladies and gentlemen of the Congress and others present, my name is John Bush. I operate a small cattle ranch in Sand Hills, NE. I am also the secretary-treasurer of an ad hoc organization called PCA Stockholders of North Central Nebraska. Thank you for the opportunity to address this hearing of such distinguished people. Let me apologize for being late. I guess the country boy is in the city, and I am here to learn. Please work with me.

Our story is about the Valentine Production and Credit Association now in liquidation since November 9, 1984. I was a borrower of that association, unaware that it was about to be eliminated. News broke that the PCA was in financial difficulty. Before that, our local president stepped down to a loan officer's position and a man from the Omaha district was installed as president. The stockholders received a letter from our local board chairman saying there was financial stress but that the PCA was not in danger of failing financially, that there was a merger being proposed between our association and another nearby and this would benefit both. The president of the other loan association was then installed as president of both associations while merger talks proceeded.

There was a media blitz of advertising telling us our PCA was strong, a friend of the farmer rancher, and would be here for years to come. A man who found another lender before it was too late told me when there is smoke, there is fire. He was certainly right.

On November 9, 1984, they liquidated our PCA without warning. As I understand it, the directors were called to a board meeting. In fact, the wife of one told me she thought that he was going to work on the proposed merger. When the board met, they were instructed by the FICB-Omaha to vote for liquidation and resign their positions, that FCA officials were on standby in Washington and were prepared to fly to Valentine and liquidate the PCA involuntarily.

Yesterday, I asked Ron Erickson of the FCA if this was true, if they had a part in this, and all he would say was, maybe yes, maybe no. It should also be noted that the PCA was loaning money the day prior to liquidation and, of course, this included the sale of stock.

Now, the financial statements indicate a tremendous loss in loan volume for about 2 years before liquidation if, in fact, these figures are correct. Isn't it the fiduciary responsibility of your employees to inform the stockholders of the conditions of their business? We had a right to know, but it was denied and even covered up. The stressful period seems to be mainly 1983 through 1984 when loan volume dropped from around $70 million to approximately $34.5 million. There was no annual meeting held in the spring of 1984 for fiscal 1983, and we were liquidated in November 1984.

I would like to also add that when the board left the boardroom after liquidating and resigning their positions, the employees were called into the boardroom, fired, and asked to collect their personal things and leave. When they returned to their work areas, there were at least 20 people waiting to supervise their actions. I would like to ask if this is the American dream.

Again, there was no annual meeting held in the spring of 1984 for fiscal 1983, and we were liquidated in November 1984. Financial statements were not available for 1983 and 1984 until 1985, after we were liquidated. We feel that we have been manipulated and deceived by someone.

Our association loan volume fell by over half during 1983 and 1984. Why? One reason was that the interest rates being charged were not competitive with commercial banks, and a tremendous number of borrowers, the best borrowers, left the system. This left the Valentine PCA with a much-higher percentage of loans with less quality.

I don't feel responsible for this. Magazine articles, in fact, I have read, including the Farm Journal indicate this is a national phenomenon of the Farm Credit System, that they are becoming the lender of last resort. Another reason for our demise may be the large percentage of big loans that went bad in our association. However, any loan over $750,000 had to be approved in Omaha.

Did accounting procedures make it look worse than it really was? Was there more involved than an already hard hit local agricultural economy? One thing I do see as a country boy from the sand hills is that the Farm Credit System appears to have new office buildings everywhere, and I know the employees are paid well. The salaries, pensions, and benefits in the Omaha district increased substantially during a time when the man paying the bills is suffering very severe financial stress, and it is the interest I was paying that financed the system.

I also understand that there are loss sharing agreements signed between all the associations in the system except one. These agreements ensure the financial stability of each association. In fact, our attorney informed me that loss sharing agreements are legally binding contracts. Why was the Valentine PCA liquidated instead of saved? The liquidation surely did not benefit the borrower.

The Farm Credit System is the fourth largest lender in the world. Our area lost its biggest lender. Our territory was given to another PCA, but at this time, I don't believe over 20 percent of the loan volume has been transferred. I wonder how much of the total volume in the whole system will be transferred when and if the proposed systemwide merger is completed if only 20 percent of our volume was.

When you borrow money from a PCA, you had to purchase stock in the association to do so. That was easy because they loaned you the money for the stock, too. If you needed $100,000, you borrowed $110,000. But if you paid the $100,000 principal, the $10,000 stock loan was canceled also. I was told not to worry about the stock loan. No risk was ever disclosed, but now in liquidation, we have to pay the stock loan, too.

We don't feel responsibility for that loan. Had I known there was risk involved, I would have financed elsewhere if at all possible. What would you have done? We feel manipulated and deceived. We were not informed of financial conditions. Binding loss sharing contracts were not used. We suddenly have an additional 10 percent financial burden with no disclosure, and we wonder why.

When you hear about Project 1995, liquidation corporations, mergers which will eventually remove the stock from the stockholders, borrowers not feeling like the system is operating for its benefit, your stories of executive takeovers of a bank holding company involved in the Farm Credit System, it makes us all wonder out in rural America what is really happening.

We feel that it is too big for us to fight alone, and we need your help. The stockholders are split. The stock is frozen in a lot of PCA's across the country. Naturally, those people feel, gee whiz, if we have a merger, maybe I won't be stuck for this liability on the stock. Those whose stock isn't frozen are wondering if it is going to be. Our stock is already frozen. We are being asked to pay for it, and we don't feel things are right.

In the Spokane district, I understand they filed a suit trying to stop liquidation. At a hearing, the PCA association, the stockholders, walked in with one attorney and met seven attorneys from the FICB-Spokane. They assured me that seven minds definitely had an effect on the outcome of that hearing.

They have an enormous amount of money to fight their legal battles with. We have none at all. What money we have is raised. Charlene and I came here to Washington with the help of a farm organization, Farm Crisis Committee, from Emerson, NE. They paid our airfare here and told us if we come to Washington, we will try to teach you how to go talk to your Senators and your Representatives.

I have discovered that I like my Representatives, that they are willing to talk to me, and I do appreciate that. We are trying to learn how to come to Washington as rural Americans and be heard.

That is all I have to say, Mr. Chairman. Thank you.

Mr. JONES of Tennessee. Thank you very much, Mr. Bush, for a good statement. We do appreciate your being here and the fact that someone was interested enough in both of you to see to it that you did come to testify.

This finalizes the witnesses except for one Member of Congress who has not appeared, and we will handle that later. I now yield to Mr. Stenholm for any questions he might want to direct to the witnesses.

Mr. STENHOLM. First, Mr. Bush, I am sure your question of why was Valentine liquidated rather than saved will be answered as we pursue the hearings. You pose a good question and one that I know this committee is going to be interested in as we delve into the problem we are here talking about.

First, Mr. Holbrook, Mr. Hill, Mr. Hanson, are you all directors, officers of your PCA, Eastern Idaho PCA, or borrowers?

Mr. HILL. I am the president of Eastern Idaho PCA. Mr. Holbrook is the vice chairman of the board. Mr. Hanson is our legal counsel.

Mr. STENHOLM. We have had several witnesses thus far that have commented on the recent statements of the Farm Credit Administration that they need additional powers. You testified in your statement on page 8, you too say controls need to be imposed to ensure better management and supervision.

My question is, Are you agreeing with FCA that they need additional powers or are you saying that they have what they need but need to do a better job in administering those controls?

Mr. HILL. We think they have adequate powers. It is just a matter of implementing them and following through on the authorities that they have right now.

Mr. STENHOLM. In light of Ms. Reiser's and Mr. Bush's problems in dealing with Valentine, would you offer any guidance for this subcommittee on some of the direction that we might need to be moving as far as giving oversight to farm credit?

Mr. HILL. Well, right off the top of my head——

Mr. STENHOLM. Strike that question. I don't want to put you on the record answering that question right now. That is imposing judgments. I don't want to ask that right now.

What I do want to ask you, though, is what has been your philosophy in your PCA regarding reserves?

Mr. HILL. We have been profit oriented for a good many years, and we kind of agreed with the gentleman yesterday that those reserves should have been increased. I think he was talking in terms of 3.5 percent of year-end balance. That is the maximum that you could put in there. We question whether that was adequate or not, but we always desired every year to—that is a nontaxable entity as far as the associations are concerned, but we have paid taxes. We don't object to paying taxes. We want to put some surplus away even though it is after tax income.

So, we have had a very positive earning philosophy for a good many years.

Mr. STENHOLM. We have had some witnesses that have testified not only on this particular issue but on other issues regarding cooperatives that the cooperatives should be there to serve the member, the farmer, and that the first prerequisite, in this case now, to credit policy is to loan the money the cheapest possible way at the cheapest possible rate.

My question on philosophy, and I want to be sure that I understand it—I believe you are in agreement with my own PCA on this. My board of directors where I borrow money have always taken the position that they are willing to pay the tax on the profit. They charge a little higher interest rate in doing that. They pay a little taxes, but they have laid back the reserves for a rainy day situation.

We have the other philosophy that comes before this committee that says that is not a good philosophy. The thing that we must do is charge the cheapest rate of interest and avoid paying the taxes.

I have found invariably in all cooperatives when you do that, the co-op goes under because the members' loyalty to that co-op is only as long as it is advantageous to them.

Mr. HILL. I agree with your statement. I agree with it.

Mr. STENHOLM. I think for this subcommittee one of the things that we are going to find awfully interesting as we look at—I hate to use the word bailout, but it doesn't have a negative connotation with me because we are talking about saving agriculture in whatever we do—that we are going to have some interesting times in rationalizing philosophical differences in cooperatives, in PCA's in this case, which are cooperatives. I appreciate your answer, and I appreciate the policy that you have followed, because I think it is the correct one, and I really think, although hindsight is always 20-20, but it is very interesting after Mr. Cobb and the Rolling Plains

PCA of Stanford, TX for 10 years asked for additional reserves to be laid by for a bad time. Six weeks ago they came in and OK'd that particular philosophy and that particular policy.

My time has expired. Thank you.

Mr. JONES of Tennessee. Thank you, Mr. Stenholm.

I regret this, but there is another vote on the floor of the House, and we have approximately 9 minutes to get there. I think we will recess the subcommittee at this point and insist and urge the members who are here to return if they possibly can. We will recess for 15 minutes.

[Recess taken.]

Mr. JONES of Tennessee. The subcommittee will resume its sitting.

I hope we can complete our hearings before we have another interruption. Mr. Stenholm had finished, so I now yield to Mr. Evans of Iowa for any questions he might have.

Mr. EVANS of Iowa. Thank you, Mr. Chairman.

I would like to address some questions to the gentlemen from Idaho. I would like a more complete explanation of the tax situation of PCA's and what of your income is taxable and what of your income is not and what is the difference in tax treatment depending on the disposition of earnings to the PCA's. I think before we finish with this whole subject of what we do about farm credit, it is well that we have on the record some explanation of this, and I think that there are a number of members, if not of this subcommittee, certainly of the whole Agriculture Committee who do not have any feeling for the tax treatment of earnings in such cooperatives.

If you could go into that for just a moment, I think it would be very useful.

Mr. HILL. I think in our regulations we first have to pay the operating expenses. The next thing I think is to restore any unimpaired capital. If we have impaired capital, we have to restore that.

Mr. EVANS of Iowa. Any unimpaired what?

Mr. HILL. If there is impaired capital, we have to restore that.

Mr. EVANS of Iowa. Oh, capital.

Mr. HILL. I think the next order is that we have to fund our reserve for bad debts, and that is 3.5 percent as the maximum. You can contribute up to 0.5 percent of your year-end volume up to a maximum of 3.5 percent. That is what is allowed under IRS and the regulations, I believe—I know it is 3.5 percent.

Mr. EVANS of Iowa. If you do that, that is not taxable?

Mr. HILL. That is nontaxable. Anything over that, you are in the regular corporate bracket. Either there is a certain percentage of the first $25,000, and you pay a certain percentage of the next $20,000. Then, when you get up to, I think, over $100,000, I think it is 46 percent. But we are subject to the same rate as any other corporation.

Mr. EVANS of Iowa. And once you have paid the taxes on those funds, you call it what within the PCA, net worth, earned net worth?

Mr. HILL. Anything left over goes into our surplus account.

Mr. EVANS of Iowa. Surplus account. Very good. I appreciate that explanation.

Since I have a bit more time, I would like to explore a bit the motives for your resistance to the merger, and I come at it as one who is quite sympathetic to your concerns, but was the reluctance to participate in this due to the fact that you viewed yourselves as a sound, prudently managed PCA and did not wish to jeopardize that position within your own association by joining with the others? Or what was your motivation?

Mr. HILL. Yes, that was our principal motive. We consider ourselves in a sound position, and we couldn't recommend to our stockholders that they put their assets into a merged PCA and lose our local control, our grassroots input, our board of directors and so forth. The board of the directors took that stand, and that is what we went to the stockholders with.

Mr. EVANS of Iowa. Now that you are not merged and the others are and you have a duplicate territory, are the FCA or the banks planning any other action against you or discriminatory policies?

Mr. HILL. Well, there have been a few implications. I don't think it has been finally approved by FCA yet. We question the validity of chartering over our territory and without our stockholder vote. We didn't have the opportunity of voting on that issue, and we think that is some concern.

Mr. EVANS of Iowa. Have you gone to court?

Mr. HILL. No, not yet.

Mr. EVANS of Iowa. But you might after an appeal is answered or where there is a judgment made on your appeal through the FCA?

Mr. HILL. That is a possibility.

Mr. EVANS of Iowa. Up to this point, they have not denied you access to funds?

Mr. HILL. No.

Mr. EVANS of Iowa. Do you anticipate that they might? I know in some parts of the Midwest this has been threatened, and as I recall, there is something in the 1995 study about perhaps denying access to funds to those who don't vote to merge.

Mr. HILL. Well, I think if they did that, I think it would be illegal because the law states that they are supposed to furnish us with the source of discount.

Mr. EVANS of Iowa. Yes; thank you.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Evans.

Mr. Stallings, I yield to you for any questions you might have.

Mr. STALLINGS. Thank you, Mr. Chairman.

Mr. Hill, why do you suppose the other 21 PCA's and 40 Federal land banks supported the merger plan? Do you feel that there was, as Senator Grassley said before this body yesterday, that a lack of information at the local level or perhaps even coercion from district management to go along with the merger and consolidation plans? Then, I keep hearing talk of sanctions. Would you comment on those?

Mr. HILL. I believe that a lot of people thought that was the only route to take, and I don't think they questioned the officials of the discount bank when the plan was presented. I think they had faith in them, complete faith in them, and I don't think they made the effort to inform their membership.

We didn't think it was the way to go. We tried to inform our membership and tell them what was going on, because they were going to make that determination. So, we thought we had an obligation to inform our membership, and that is what we did.

I think that all the communication from the other associations I think was positive, so there wasn't an opposing point of view even presented to them, and we were under the impression that there was no other alternative, no other alternative other than to merge all the PCA's and the Federal land banks. They were told that, that there is no other alternative, that the consequence was going to be the failure of the FICB, that they would put them in liquidation. For that reason, I think they believed that and they were sent to their stockholders with that kind of a situation.

Mr. STALLINGS. What does the term "sanctions" mean?

Mr. HILL. Well, from what I can determine as far as the bank is concerned, those were to put some restrictions on us. We hear a lot about sanctions with South Africa. We hear that in the press most every day recently. In a visit with the officials of the bank about 10 days ago, they said they wished they had never mentioned the word.

There were implications for higher interest rates, that our loan authorities would be withdrawn, that the amount of money that we could loan would be limited to a proportion of our net worth, and there was even implications as far as our help was concerned that they would be trying to get our help to staff these other service centers as they call them. That is the implication as far as sanctions are concerned.

Mr. Holbrook was up at that meeting. Maybe he has something to add. I don't know.

Mr. HOLBROOK. Mr. Chairman, to me I get the impression that the sanctions were to be imposed on us to restrict us, to make it more difficult for us to serve that territory so that we would eventually ask Spokane to be admitted into the one PCA concept. Now, this is a personal opinion, and I don't know how far I should go in mentioning this, but from conversations, from statements that have been made, this is why they were imposing the sanctions.

Mr. STALLINGS. Let me follow that up, then. If the Farm Credit Administration approves the Spokane district's amended merger plan which will essentially create one super, interstate PCA excluding Eastern Idaho PCA, that will in fact directly compete with Eastern Idaho PCA in a service territory, do you expect Eastern Idaho will remain a financially viable association? And what recourse do you have?

Mr. HILL. Well, we question it. We don't think that as far as continuing to be a viable PCA, we have considerable amount of competition from the commercial banks right now, and they do a good job. We don't feel too bad about competing with them, but to have a similar institution and to compete head to head with a similar institution we don't think is very good.

We have a supervisor now since the first of the year who would be both supervising the interstate PCA and also us. So, I question how you can do that without a conflict of interest. You could divide the amount of volume. It could lead to that, and I don't think it would be in the best interests of the members in the territory.

After all, we have 24 counties in Idaho and there are only 44 counties in the whole State. So, we have more than a majority of the counties in the State of Idaho. We don't see how that could be a very good situation for either the interstate PCA or ourselves as far as staying viable. Eventually, one of us isn't going to be.

Mr. STALLINGS. Mr. Chairman, may I have additional minutes?

Mr. JONES of Tennessee. Without objection, the gentleman is allowed 2 additional minutes.

Mr. STALLINGS. Does the Spokane PCA have enough funds that it can compete with you? Is that their purpose, to be in the business of competition with other PCA's?

Mr. HILL. I think that they are going to establish these service centers in the Federal land bank offices that are already in place within our territory. Now, that will mean that they won't have to have locations or have to rent additional property or anything else. And there is a possibility that they can operate cheaper than we can from that situation, particularly if they can utilize their Federal land bank staff, their long-term staff, if they can train them and get them trained. Perhaps they can get more efficiency from that kind of a standpoint. That will remain to be seen.

I think in the short term, maybe in the next year or so, we would not have too much difficulty competing with them. But in the long term, I think we would have a very difficult situation.

Mr. STALLINGS. What recourse do you plan to take if they do in fact compete with you?

Mr. HILL. Well, we haven't had a board meeting recently, but we are considering about the only issue that we have. It is a legal issue. The board hasn't made that determination yet.

Mr. STALLINGS. Mr. Hanson, have you mentioned the possibility of a law suit with the Spokane PCA?

Mr. HANSON. I probably shouldn't comment too much on that, but let me say for the record, exhibit 11 to the written testimony consists of a letter that I wrote to Mr. Wilkinson on behalf of the association. I did so at the invitation of Mr. Badero, the chief counsel, which in turn resulted from a telephone conversation I initiated to him, having had a chance to meet him before. There seemed to be some interest in having us outline our legal positions, however briefly that was. So, having previously been asked to do some basic research, I put that letter together.

I guess that maybe confirms Mr. Hill's statement. Obviously, there has been some discussion by the board in the past as to what recourse we have, and if all else fails, then you look at the possibility—I don't want to overstate it—but the possibility of legal action. I think I can speak for the association in saying that would have to be their very, very last recourse. They are not a litigious organization, and they would like to see this thing worked out in a more reasonable fashion. Hopefully, it can be.

Mr. STALLINGS. Thank you, Mr. Chairman.

I would just like to thank these gentlemen for coming here and for their fine testimony. I think it is tragic that when farm finance is in the shape that it is in that these people have to spend their time just trying to survive to be a viable lending institution rather than doing the job that they are chartered to do and that is to help farmers. Thank you.

Mr. JONES of Tennessee. Thank you, Mr. Stallings, and thank you, gentlemen.

We have in our presence today a former and very valued member of the subcommittee. He is still a member of the full committee, Mr. Glenn English of the State of Oklahoma. Glenn, if you have any questions, I would like to recognize you for that purpose.

REMARKS OF HON. GLENN ENGLISH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OKLAHOMA

Mr. ENGLISH. Thank you very much, Mr. Chairman. I don't really have any questions. I was very interested in the testimony. I would like to make a couple of observations.

I might point out for those who are not familiar, I grew up with the Farm Credit System. My father was the president of a local Federal land bank for 35 years and retired in 1975. He is at the present time a member of the local board.

In looking at what is taking place, I think it might be of value to the subcommittee to look at more than just the fact that what we have is a crisis in the Farm Credit System as a result of the difficulties in agriculture. In 1969, the Farm Credit System pretty much got their independence once they paid off their obligations and loans to the Federal Government. At that time, there began a shift, a change taking place within the system itself, and we saw the beginnings of movement away from local control. This is not something that has started just recently.

I can remember back not too many years ago the local boards used to meet nationally where they would get together and discuss the problems and the developments taking place in the system. That was done away with, so that type of communication did not take place. There are a number of instances in which this evolution has been ongoing.

The Federal land bank itself was always, at least for the time my father was in it, a rather conservative institution. As far as their valuation of the farmland, it was pretty conservative. Whenever they would go out and take a look at that land, the loans themselves would be for 70 percent of that value which were very conservative when it was compared with other lending institutions around the country.

My father said the one thing he was always most proud of is during that 35 years that he was a member, and he started out during the Great Depression, they never foreclosed on a farmer during that entire period. At that time, particularly during the Depression, we had programs underway in which we would try to work with the farmers and even if that farmer could just pay a little something on his interest and was making the effort, the institution itself had a policy that it would try to work with him and try to move along. They recognized that it was important to keep farmers on the land, because if you didn't and you simply took that land out and put it on the market, it probably wasn't going to bring much of anything anyway.

We are into some similar times as that today, but we don't have that same kind of policy or approach. It is a much more abrupt type of decision that is being made, and those decisions are not being made by the local board members. The local board members find that, for the most part, they have very little to say about the entire matter.

Which gets us down to the situation within the Wichita district which is a little different and unusual in that we have a superboard that is being designed there, and it is my understanding that should that work well, that will be put on the entire Nation in all the various districts in which we would have, for instance, most of the States in our district with the exception of New Mexico would have two board members and the State of New Mexico would only have one.

That is going to replace the local board members that we have had over time. It is supposed to take care of representation by the stockholders approach. This is being foisted upon the stockholders. I should say the local boards themselves are saying, well, we really don't have any choice. We have to do this because we have to save money, because of all the difficulties that we are having.

What is not being told is that this is not going to be enough to take care of the problem. They are still going to have to come to Congress and ask for help.

I suspect way down somewhere in the bowels of development of the farm credit policy that someone said this is something that we want to evolve to anyway. Senator Charles Grassley, I know, has brought out and made the statement that what we have is the professional managers taking over from the stockholders. I think it could be compared to a mutiny, if you would, in which they are taking over from the actual cooperative ownership.

However, as I said, I would point out to you that the roots of this go back much further than just the past couple or 3 years and with the problems we are having in agriculture. This has been the thrust.

I think there is some other evidence. The so-called Project 1995 certainly, I think, points in that direction that this is not just a consolidation of authority and moving that authority up to the district level and perhaps on in to Washington of an institution, but is also designed to spread out and to go into every aspect of banking, to become something that certainly was never considered. I would urge, Mr. Chairman, that the Project 1995 memo become a part of the record and that the members be made aware of that.

So, I would look at it that we really have two problems. One question here is the one of local control in which the control has been taken away from the stockholders and, in effect, we are no longer going to have a cooperative and we are going to have a professional management out of Washington which will control everything or at least at the district level. The second is the impact that the present farm problems are having on every aspect of the Farm Credit System.

I would point out that the testimony that we have had today points out that you do have areas in which not every PCA in the country or every Federal land bank in the country is in trouble. You have certain areas where there are economic difficulties. Certain PCA's and Federal land banks may be experiencing trouble in certain regions.

However, with the project that is underway now, we are going to condemn the rest of the country to share the same fate because we are going to spread this trouble out throughout the Nation. What it means is that it has to come before this subcommittee and the Nation as a bailout of an entire national system rather than trying to deal with the problems of specific areas.

So, that is just a few observations, Mr. Chairman. I am hopeful that maybe the subcommittee will look at the two aspects of this problem, not just one.

Mr. JONES of Tennessee. Thank you very much, Glenn, for a very strong and sound suggestion that this subcommittee do that. As I meant to say if I did not say earlier, we have always leaned pretty heavily on you for advice about some of the things that we do here in this subcommittee, because we do miss you very much.

I think rather than to make Project 1995 a part of this hearing, it might be better to make it an exhibit for reference and urge that it be referred to. Many of us already have seen it, and due to the fact that these hearings are going to be rather lengthy anyway and the expense involved, maybe, without objection, we had better do that.

Mr. ENGLISH. I heartily agree, Mr. Chairman.

Mr. JONES of Tennessee. Without objection, then, Project 1995 will be made an exhibit as some others we have referred to in these hearings will also be made an exhibit to these hearings. The subcommittee members need to be urged, if they have not seen it, to give it a good look before we proceed further.

Mr. Stenholm, you have returned, and evidently you returned for some purpose other than just to make the chairman feel good. Do you have a question?

Mr. STENHOLM. I have one question of Ms. Reiser. How long have you and family been a borrower in the Valentine PCA?

Ms. REISER. Approximately 8 years.

Mr. STENHOLM. Eight?

Ms. REISER. Yes, sir.

Mr. STENHOLM. Had you had any problems with your relationship with the management of the PCA prior to this unfortunate circumstance you have described to us?

Ms. REISER. None at all.

Mr. STENHOLM. Was the relationship good?

Ms. REISER. Well, we thought it was good. We got along good.

Mr. STENHOLM. You had no complaints about the service or the manner in which your loan was handled prior to this unfortunate circumstance?

Ms. REISER. No.

Mr. STENHOLM. Thank you.

Mr. JONES of Tennessee. Thank you very much, Charlie.

This does conclude the hearing. I am going to reserve and I am going to ask unanimous consent that the subcommittee members be permitted to correspond or to contact any of you who have been witnesses on this panel today in case we need to as far as your testimony is concerned for our future needs. Without objection, we will do that very thing, because time is of the essence.

Mr. Bush, I appreciate the fact that you did finally make it. I knew you were in town. I talked to Hal Daub and he said you were on your way. We are glad that you made it over here for the hearing.

We do appreciate the fact that all of you are here.

Congressman Conyers of Michigan notified us that he had a statement to make. He has not shown, so I am going to ask unanimous consent that he be permitted to file his statement if he so desires, without objection. Without objection, he will be permitted to do so.

This does conclude the set of hearings that we have had scheduled for the 11th and 12th of September. I want to personally thank each of you who have appeared and are appearing for your participation. Don't get upset because the members are not here all the time. That is something that we have a problem with here. I have had it with some of my subcommittees and so do other members as well. However, they will take a good, deep look at what you have said.

I can assure all of you that we are going to be concerned, more than probably many of you understand or realize, with the problems facing rural America. We know the problems that are out there. Many of us do. We want something done, too.

I happen to be a farmer. I have always farmed. In fact, that is my background, and I am as concerned as you are. I am a customer of my PCA and also of the Federal land bank, and I am as disgusted and as dismayed as you folks are with many of the problems that have arisen.

Glenn English made some statements there that need to be considered and considered deeply about the independence that the Farm Credit System has assumed since they became independent of the U.S. Government back in 1969. It has made somewhat of a difference since then. I know that, and I think many of you do. I think many of the employees of the system are aware of that. It is just one of those things that come and go with time, and it is going to be the responsibility of this subcommittee that something is halted and some other things are done in that regard. .

I was here when we updated the Farm Credit Act of 1971. I was also here in 1980 when the same thing happened. I know the problems that we face. Many of the members know likewise the same as I do.

With that, I want to thank you again, and the subcommittee stands adjourned until the call of the Chair.

[Whereupon, at 1:17 p.m., the subcommittee recessed, to reconvene subject to the call of the Chair.]

[Material submitted for inclusion in the record follows:]

National Cooperative
Business Association
Representing America's Cooperative Business Community

STATEMENT OF THE

NATIONAL COOPERATIVE BUSINESS ASSOCIATION

TO

SUBCOMMITTEE ON CONSERVATION,
CREDIT AND RURAL DEVELOPMENT

OF THE

HOUSE AGRICULTURE COMMITTEE

Presented By

E. MORGAN WILLIAMS
PRESIDENT
SEPTEMBER 12, 1985

National Cooperative Business Center
1401 New York Avenue, N.W., Suite 1100 • Washington D.C. 20005 • (202) 638-6222 • Telex: 440344

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GOOD MORNING. MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE.

THANK YOU FOR ALLOWING ME TO APPEAR BEFORE YOU TODAY TO TESTIFY ON THE FARM CREDIT SYSTEM. I AM THE PRESIDENT AND CHIEF EXECUTIVE OFFICER OF THE NATIONAL COOPERATIVE BUSINESS ASSOCIATION, A NATIONAL MEMBERSHIP AND TRADE ASSOCIATION REPRESENTING ALL TYPES OF COOPERATIVE BUSINESS INCLUDING OVER SEVENTY AGRICULTURAL MARKETING AND SUPPLY COOPERATIVES ACROSS THE UNITED STATES. THESE COOPERATIVES ARE DEMOCRATICALLY OWNED AND CONTROLLED BY OTHER COOPERATIVES AND/OR THEIR FARMER-MEMBERS AND RELY ON THE FARM CREDIT SYSTEM AS ONE OF THEIR MAJOR SOURCES FOR FINANCING.

SINCE 1916, IN ONE FORM OR ANOTHER, THE FARM CREDIT SYSTEM HAS EXISTED IN ORDER TO MEET THE CREDIT NEEDS OF FARMERS, RANCHERS AND THEIR COOPERATIVES. THE SYSTEM HAS NOT ONLY PROVIDED THE FARMERS IN THIS NATION WITH THE CREDIT THAT HAS ENABLED THEM TO BECOME THE MOST EFFICIENT PRODUCERS IN THE WORLD, BUT HAS SERVED THE GENERAL PUBLIC BY MAKING IT POSSIBLE FOR THE PRODUCERS OF OUR FOOD AND FIBER TO INSURE AN AMPLE SUPPLY OF HIGH QUALITY PRODUCTS AT LOW COST. IN GOOD TIMES AND BAD, THE FARM CREDIT SYSTEM HAS PROVIDED LOANS TO CREDIT WORTHY BORROWERS IN RURAL AMERICA -- INDEED FOR THE LAST 60-ODD YEARS.

THE FARMERS AND COOPERATIVES THAT BORROW FROM THE SYSTEM BECOME OWNERS OF THE SYSTEM BY PURCHASING STOCK WHEN BORROWING FROM THE SYSTEM. THIS IS A REQUIREMENT TO BE ELIGIBLE FOR LOANS FROM THE BANKS.

(THE SYSTEM TODAY COMPRISES TWELVE DISTRICTS WITH A FEDERAL LAND BANK TO HANDLE LONG-TERM MORTGAGE LOANS THROUGH LOCAL FEDERAL LAND BANK ASSOCIATIONS; A FEDERAL INTERMEDIATE CREDIT BANK TO PROVIDE FINANCING TO FARMERS FOR SEASONAL OPERATING PURPOSES THROUGH LOCAL PRODUCTION CREDIT ASSOCIATIONS; A BANK FOR COOPERATIVES WHICH PROVIDES OPERATING LOANS TO COOPERATIVES WHO OWN THE BANK. LASTLY, THERE IS A CENTRAL BANK FOR COOPERATIVES THAT PARTICIPATES IN LOANS TO LARGER COOPERATIVE BUSINESSES AND ALSO SERVES THE DISTRICT BANKS BY TRANSFERRING LOAN FUNDS FROM BANK TO BANK).

TO LAUNCH THE SYSTEM, THE GOVERNMENT FIRST INVESTED IN THE FEDERAL LAND BANK CAPITAL STOCK. MANY WERE SKEPTICAL THAT THE GOVERNMENT'S INVESTMENT WOULD EVER BE REPAYED. THE LAND BANKS AND OTHER PARTS OF THE SYSTEM HAVE LONG SINCE PAID OFF ALL THEIR GOVERNMENT CAPITAL. TODAY, THANKS TO THE SYSTEM'S EXCELLENT RECORD OF REPAYMENT, OTHER ORGANIZATIONS INCLUDING FEDERAL DEPOSIT INSURANCE CORPORATION, EXPORT-IMPORT BANK OF THE UNITED STATES, FEDERAL NATIONAL MORTGAGE ASSOCIATION, AND FEDERAL HOME LOAN BANKS HAVE FOLLOWED THE FARM CREDIT SYSTEM'S LEAD.

BY REPAYING THE GOVERNMENT IN ITS ENTIRETY, THE SYSTEM BECAME FARMER-OWNED, WITH LESS RELIANCE ON GOVERNMENT. THE SYSTEM HAS RETAINED A CLOSE WORKING RELATIONSHIP WITH THE GOVERNMENT THROUGH ITS REGULATORY AGENCY, THE FARM CREDIT ADMINISTRATION.

TODAY, THE SYSTEM HAS NET LOANS OF $74 BILLION AND IS SUFFERING NET LOSSES FOR THE FIRST TIME SINCE ITS CREATION. THE DETERIORATION OF AGRICULTURE CONTINUES TO WORSEN AND SOME PARTS OF THE SYSTEM ARE FACING STAGGERING LOSSES DESPITE AGREEMENTS TO SHARE LOSSES AMONG ALL THE BANKS. ONE OF THE MAJOR GOALS OF THE COOPERATIVE FARM CREDIT SYSTEM IS TO PROVIDE CREDIT TO ITS USERS AT THE LOWEST POSSIBLE COST. THEREFORE, LOAN MONEY MUST BE OBTAINED AT THE LOWEST POSSIBLE COST.

THE SYSTEM HAS SURVIVED TWO WORLD WARS, THE GREAT DEPRESSION AND CYCLICAL YEARS OF DROUGHTS AND FLOODS. AND WITH MAJOR ADJUSTMENTS, THE SYSTEM SHOULD BE ABLE TO CONTINUE AS A STRONG FINANCIAL LENDER TO AGRICULTURE. IT IS MORE SORELY NEEDED UNDER PRESENT CIRCUMSTANCES THAN AT ANY TIME SINCE THE GREAT DEPRESSION OF THE 1930'S.

AS THE SYSTEM HAS GROWN, THE STRUCTURE HAS BECOME SO LARGE THAT IT IS LIKE A LARGE CATEPILLAR STRUGGLING TO MOVE FORWARD BUT HAVING TROUBLE WITH ITS BODY MOVING IN SYNCHRONIZATION.

I WILL NOT APPEAR TO QUALIFY MYSELF AS ABLE TO ARTICULATE ALL THE PRESENT PROBLEMS OF THE SYSTEM. IT IS NO SECRET, HOWEVER, THAT MANY FARMER-BORROWERS ARE DISMAYED BY SOME PRACTICES THE BANKS HAVE INSTITUTED IN THE LAST FEW YEARS. IN PARTICULAR, THIS YEAR, THEY ARE CONCERNED THAT THE MOVE TOWARD CENTRALIZATION WILL LESSEN THEIR CONTROL AS FARMER-OWNERS OF THE SYSTEM. FARMERS AND THEIR COOPERATIVES ARE UNDERSTANDABLY UPSET BY

RECENT EVENTS INCLUDING THE INCREASED LOAN COSTS BY THE SYSTEM. AS THE SYSTEM TRIES TO HANDLE THE MASSIVE LOSSES BY THE DISTRICT BANKS, OUTSIDE INVESTORS HAVE BEEN LESS ANXIOUS TO BUY SYSTEM SECURITIES AND FARMERS ARE TURNING TO INSURANCE COMPANIES AND COMMERICAL BANKS FOR CREDIT AS THEIR LOAN RATES ARE LOWER.

THE SUPPORT OF ITS FARMER-OWNERS ARE CRUCIAL FOR THE SURVIVAL OF THE SYSTEM. THEIR BACKING WILL BE NEEDED FOR ANY NECESSARY STRUCTURAL CHANGES TO THE SYSTEM. WITH THE RATES FOR BORROWING INCREASING DAILY DUE TO LOAN LOSSES, FINANCIALLY STRESSED FARMERS ARE FEELING ALIENATED FROM THEIR COOPERATIVE BANKING SYSTEM.

WHILE THE SYSTEM PROVIDES ONE THIRD OF THE CREDIT OF FARMERS, IT ALSO PROVIDES TWO THIRDS OF THE CREDIT TO AGRICULTURAL COOPERATIVES. IT IS VITALLY IMPORTANT TO REMEMBER THAT SERVICING CREDIT NEEDS FOR COOPERATIVES AND FARMERS REQUIRES DIFFERENT AREAS OF EXPERTISE AND FLEXIBILITY. THE BANKS FOR COOPERATIVES HAVE HAD THE ADVANTAGE OF A ONE-TIER STRUCTURE, ALLOWING IT TO RESPOND MORE QUICKLY TO OUTSIDE CHANGES IN THE AGRICULTURAL ECONOMY AND COOPERATIVE BUSINESS COMMUNITY. THE SYSTEM MUST ACT QUICKLY TO REGROUP AS A MORE EFFICIENT ORGANIZATION AND MUST TAKE INTO ACCOUNT THE VARIOUS NEEDS OF IT DIFFERENTIATED CUSTOMER BASE.

AS FAR BACK AS 1933, THE GOVERNMENT HAS INTERVENED IN TIMES OF ACUTE FINANCIAL DISTRESS IN THE AGRICULTURAL COMMUNITY. BY THEN, THE FEDERAL LAND BANKS HAD PAID OFF THEIR ORIGINAL GOVERNMENT CAPITAL. CONGRESS APPROPRIATED NEW CAPITAL AND PROVIDED VARIOUS MEASURES TO ENABLE THE BANKS TO TAKE ON THE CONGRESS-DECREED JOB OF SAVING HUNDREDS OF THOUSAND OF FARMERS FROM FORECLOSURES. CONGRESS ALSO PROVIDED THE CAPITAL TO ESTABLISH AN EMERGENCY FEDERAL FARM MORTGAGE CORPORATION FOR RISKY LOANS TO HELP THE LAND BANKS. IT ALSO CAPITALIZED THE BANKS FOR COOPERATIVES AND THE PRODUCTION CREDIT ASSOCIATIONS. AND STILL, THE GOVERNMENT GOT ALL ITS CAPITAL BACK.

THE U.S. GOVERNMENT HAS PROMOTED THE STABILITY OF THE FARM CREDIT SYSTEM BY INCREASING THE AMOUNT OF ITS CAPITAL THROUGH PURCHASE OF NON-VOTING STOCK, AND SOMETIMES BY GUARANTEES ON FARM LOAN BONDS. WHILE GOVERNMENT CAPITAL INFUSION MAY NOT BE NEEDED BY THE SYSTEM AT THIS TIME, IT IS IMPORTANT TO REALIZE THAT THE SYSTEM HAS MET ITS OBJECTIVE OF PROVIDING THE LOWEST COST OF FINANCING AVAILABLE TO ITS MEMBER-BORROWERS --- AS A PRIVATE INSTITUTION AND, AT TIMES, IN PARTNERSHIP WITH THE GOVERNMENT.

AGAIN, MAY I REMIND YOU, THE STRUCTURE MAY NEED MAJOR CHANGES BUT THE UNDERLYING CONCEPT OF FARMERS AND COOPERATIVES AS BORROWERS AND LENDERS IS SOUND AS PROVED BY SIXTY YEARS OF EXCELLENT SERVICE TO FARMERS, COOPERATIVES AND THE ENTIRE ECONOMY. LASTLY, WHILE I HAVE FOCUSED ON THE FARM CREDIT SYSTEM, THE NATIONAL COOPERATIVE BUSINESS ASSOCIATION AND ITS MEMBERS RECOGNIZE THAT ANY PLAN DEVELOPED DURING THE NEXT FEW MONTHS MUST ENCOMPASS NOT ONLY THE SYSTEM BUT ALL FINANCIAL INSTITUTIONS WITH UNHEALTHY AGRICULTURAL LOAN PORTFOLIOS.

WE CALL ON THE FARM CREDIT SYSTEM., FARMERS HOME ADMINISTRATION, INDEPENDENT BANKS AND OTHER INVOLVED PARTIES TO WORK TOGETHER TO DEVISE A PLAN THAT WILL ALLOW THEM TO CONTINUE PROVIDING CREDIT TO THEIR BORROWERS.

WE ALSO URGE CNGRESS TO ADDRESS OUR DEFICT PROBLEM AND TO WROK WITH THE ADMINISTRATION TO BRING INTEST RATES TO A LEVEL THAT WILL KEEP FARMERS AND AGRICULTURAL MARKETING AND SUPPLY COOPERATIVES SOLVENT.

THE NATIONAL COOPERATIVE BUSINESS ASSOCIATION WILL SUPPORT THE BEST CONTINGENCY PROPOSAL PUT FORTH IN THE NEXT FEW MONTHS TO SECURE THE STABILITY OF THE FARM CREDIT SYSTEM. ON BEHALF OF OUR COOPERATIVE MEMBERS, WE URGE YOUR SUPPORT OF ALL EFFORTS TO ENSURE THE CONTINUED GOAL OF THE FARM CREDIT SYSTEM OF PROVIDING LOW-COST FINANCING TO THE STRUGGLING FARMERS AND THEIR COOPERATIVES.

THANK YOU.

TESTIMONY OF ROBERT J. GRAY,
DIRECTOR OF POLICY DEVELOPMENT, AMERICAN FARMLAND TRUST
BEFORE THE SUBCOMMITTEE ON CONSERVATION, CREDIT & RURAL DEVELOPMENT
OF THE HOUSE AGRICULTURE COMMITTEE
SEPTEMBER 12, 1985

Good afternoon, Mr. Chairman and members of the Subcommittee. I am Bob Gray, Director of Policy Development for the American Farmland Trust. As many of your know, AFT is a private nonprofit organization founded in 1980 to encourage the conservation of agricultural resources -- soil, water and the land itself. But AFT does not concern itself only with resource issues. We recognize that effective resource conservation goes hand in hand with a healthy agricultural economy. Thus, our concern extends to commodity issues, as many of your know from our role in helping to fashion a Conservation Reserve, and to the issue of agricultural credit that is the subject of these hearings.

The major point I want to make today is that *resource conservation should be an intergral part of any credit solution*, just as it has been integrated into the commodity section of the Farm Bill through a Conservation Reserve. The basic objective should be to involve our public and private farm credit inititutions in conservation, in recognition that there is a strong connection between the availability of credit and stewardship of the land.

Some of the same causes of the economic problems that today plague American agriculture are also responsible for resource degradation. Hard pressed to service a record farm debt in the face of declining collateral values, high interest rates and low commodity prices , a good many farmers are pushing their land beyond the limits of its capability and sodbusting marginal acreage, contributing to some of the worst erosion since the Dust Bowl. But, as we've seen, the resulting overproduction has simply depressed prices, further eroded the value of farmland as loan collateral, and perpetuated high interest charges as lenders seek to cover their losses.

Reversing this vicious cycle -- and preventing a recurrence -- would seem to require, among other things, that we attempt to stabilize land values and, thus, the borrowing ability of producers at a level which reflects the capability limits of the land and the need for long-term resource conservation. At the same time, the need to make sufficient credit available presents an opportunity to assure that both borrowers and lending institutions contribute to national resource conservation objectives.

The dimensions of the current credit problem would appear to demand creative thinking and extraordinary solutions. As many as one-third of the nation's farmers now have debt-to-asset ratios over 40 percent, the level generally assumed to pose a threat of liquidation. These operators collectively hold two-thirds of all farm debt. [1985 Farm Finance Survey] According to Dr. Neil Harl, the respected Iowa State agricultural economist, "Unless something dramatic is done . . . more than one-third of the farmers nationally will move to insolvency, taking down their lenders, their suppliers and other merchants, and inflicting incalculable damage upon the fabric of rural communities." [Address to American Bar Assn., July 1985]

Clearly, it is going to take some creative thinking to fashion a credit solution that will deal effectively with the problem. And in so doing, we should be equally creative in looking at ways that conservation can be intergrated into the package. Let me use a few examples of pending credit proposals to illustrate the point.

Rep. Webb Franklin has introduced a bill to permit FmHA to foregive farmers' indebtedness in exchange for conservation easements that would retire marginal land from production and preserve wetlands and other wildlife habitat. As you know, this measure is part of the Farm Bill reported by this Subcommittee and has a companion sponsored by Sen. Thad Cochran. It represents an excellent first step at relieving credit problems while securing public conservation benefits.

The Iowa Natural Heritage Foundation, a private nonprofit group like AFT, has proposed a more ambitious version of the Franklin-Cochran approach that would make additional credit available to operators who agree to resource conservation easements that would return a long-term benefit to the public while helping to stabilize production. In our view, this is a truly inspired idea that could produce results just as dramatic as the hardship agriculture now suffers.

The Farm Credit Council has proposed the establishment of an "agricultural conservation corporation" to acquire farmland and hold it so as to stabilize collateral values, prevent the further run-up of interest rates, ease the credit squeeze and make farm foreclosures less likely. It is aimed more at lending institutions than directly at farm operators, but is no less susceptible of achieving conservation goals. Indeed, the FCC is actively considering the integration into its proposal such ideas as enrollment of highly-erosive land into a Conservation Reserve and the imposition of conservation easements on prime farmland.

These proposals represent fairly divergent approaches to solving the farm debt problem and, of course, they aren't the only credit ideas on the table. (Another one, for example, would be to insist that soil and water conservation plans be followed on land financed by government loan guarantees.) We don't endorse any particular approach at this point. But the differences among these ideas merely underscore the point that resource conservation can strengthen the credit system, and that credit can work in harness with resource conservation to achieve overall stability in American agriculture.

We offer to work with this Subcommittee, and anyone else concerned with farm credit, to assure that conservation makes a contribution to the ultimate solution.

Thank you for this opportunity to testify.

NATIONAL ORGANIZATION FOR RAW MATERIALS

Fred Huenfeld, President
P.O. Box 4480
Monroe, Louisiana 71211

September 10, 1985

Congressman Ed Jones, Chairman
Conservation, Credit, Rural Development
Committe.-- U. S. Congress

Gentlemen:

I fully appreciate that your position makes you especially well informed. I probably won't tell you anything that you are not already familiar with. I hope, however, to offer a little different perception that I and a large number of concerned Americans hold to be a fundamental truth, though we recognize that if it not widely accepted in academe or in the business world.

I am sure that you realize that I wouldn't be writing you if I didn't have the self-assurance that I know the things that I know, as well as I suspect you believe you know the things that you know. I hope that there is some common ground where our respective perceptions of this matter will meet.

As I sat down to prepare this presentation, I remembered what I had seen in a recent issue of U.S.A. Today newspaper. It said,

1984 was a good year.

Inflation fell 4.3 percent, the lowest since 1972.

GNP grew 2.7 percent.

Unemployment fell 7.0 percent in August 1985.

This year (1985) looks even better.

All of these things are true and the Nation should be grateful and applaud the Administration for these positive accomplishments.

What the ad didn't say, however, is something that we read almost everyday in other newspapers and magazines. For example:

NORM
NATIONAL ORGANIZATION FOR RAW MATERIALS

TREASURER RAY DYKEMAN
BANK OF HARTINGTON
HARTINGTON, NEBRASKA 68739

There are 1 billion 35 million dollars in losses to creditors pending in the Bankruptcy Court in the Western District of Louisiana as of September 20, 1983 and 123 billion dollars in losses nationwide pending as of the same date.

Huge economic sectors are not participating in the economic upsurge of the past year, and are still seriously depressed.

Unemployment is still historically high, and unemployment compensation funds are depleted.

There is little likelihood of a balanced federal budget by either increased tax revenues, or budget reductions.

Foreign creditors are threatening the solvency of the U.S. Banks.

And, until the federal deficit is eliminated, nothing is going to work satisfactorily for very long.

This is the economic reality that most of us are living with out there. The contrast between these two observations are apparent, as are the motivations. Quite aside form that is the fact that what our economy really needs is something more than the 1983 increase of 200 billion dollars in national income, but a drastic 200 billion dollar cut in federal expenditures is not the answer either. The former isn't enough to do any good, and the latter would only exacerbate the problems just enumerated.

What the U.S. economy really needs is a very substantial surge in national income which will provide a new tax base of at least 1 trillion dollars. It would require new gross sales approximating 5 trillion dollars at retail to accomplish this, and all sectors would have to participate 'equitably' to have it work best. It should happen very soon, if possible, within the next 12 months time.

If we could achieve a new tax base of 1 trillion dollars within a year, the economic effects would be startling and very positive.

For example, the 23 percent share which would accrue to the Federal Government would yield 230 billion dollars of new tax-revenue.

The federal budget could be balanced, and further cuts in entitlements and other crtical budget items could be avoided.

Solvency would be substantially restored to the Social Security System by increased taxes paid by re-employed workers.

Unemployment would decline substantially, perhaps 30 percent or more.

With higher earnings, the private sector would require less credit; the Federal Government credit requirements would cease; and interest rates would decline dramatically.

The related benefits would be countless -- until Congress recovered from the shock and returned to a policy of lend and spend.

You may be amused at this suggestion because if this were possible, existing economic policies would have already brought it about long ago.

That is exactly the point. Existing economic policy has not accomplished this upsurge and will never do it until it first restores economic equilibrium in the total economy which approximated between 1910 to 1914. The most recent example of equilibrium was between 1943 to 1952. This was the period when we had 90% price support on our raw materials.

To understand the reality of what I suggest here, one only has to review what happened to national income of the U.S. economy from 1940 through 1943. Here, you will re-discover a very remarkable period of economic growth, which both of us witnessed in our lifetime.

If you would have your staff review this period with openmindedness and complete impartiality, I am sure that they will recognize that the economy was in relative balance (equilibrium) at that time as a result of the leveling effect of the depression of the 1930's.

They will realize that total national income increased more than 110 percent during the period and that all sectors participated fully and 'equitably'.

Why?

We were able to do all of that because we had wisely provided laws, regulations and economic restraints that assured economic equilibrium for ten solid years from 1942 to the close of 1952. It was a managed system which successfully avoided inflation and depression until it was abandoned in 1952. This was the same policy that was advocated and practiced by Alexander Hamilton, not "Adam Smith, Wealth of Nations Free Trade Theory" of the British Empire.

During this period, we preserved the benefits of the United States economy for the primary enjoyment of our own citizens, our own labor force, our own financial system, and our own business and agricultural entities. We were so prosperous and solvent in 1945 that the commercial banks of the nation could not find borrowers among all of the individuals, partnerships, and corporations in the nation for more than 17.6 cents out of every dollar of deposits. The federal reserve discount rate was 1% per annum, and short term U.S. Treasury bills were yielding less than 1% per annum interest to the investor.

Can we restore the economy from 1984 to 1987 as we did from 1940 to 1943? Perhaps not, but it is a fascinating and very refreshing exercise to achieve this insight to 'what might be' once again.

For example, if you don't mind, let us assume for the monment that 1983 was the year from which the new resurgence of the economy began. By 1986, the national income could increase by 2.6 trillion dollars on an annual basis. This would be a mighty upsurge which would provide a market for twice the goods and services sold in 1983. If we would limit imports from foreign countries to the 1983 level, it would substantially eliminate unemployment in the United States and correct most every other major economic problem. If it worked as well as it did from 1940 to 1943, there would be less inflation than the reduced level actually experienced in 1983.

The point is, if we are afraid to manage our economy to the degree that is necessary to exercise moderate economic controls and production guidelines which are necessary to legally mandate economic equilibrium and to restrain economic abuses, we are most certainly destined to retreat the cyclical effects of 'boom and bust' economic disequilibrium forever.

The constraints on your time prompt me to close my presentation with the following observations:

We have created a national public and private debt in excess of 6 trillion dollars since our nation began. Approximately 5.5 trillion of this has been created since 1952.

During the last 32 years, primarily because of poor public and private policy decisions (based on hindsight), we have dislocated an estimated 3.9 trillion dollars of cumulative profits earned by the private enterprise sectors, as measured in national income. This amount is the difference between what the national income actually was, and what it might have been had we maintained the standard of 'national income share' that was established from 1943 to 1952.

I realize, of course, that there is no way to restructure the dispostion of thirty-two years of profits or miraculously restore it to the sector that lost it, because it has been lost and it is gone forever.

Also, I know that we substituted debt to offset these "Dislocated" profits. A substituion that would not have been necessary if the 1943-1952 economic equilibrium had been consistently maintained for the past thirty-two years.

In addition, we have forced the economy, the government, business, and industry to pay 1.6 trillion dollars of excessive interest, which would not have existed because the debt would have never been incurred had we maintained a par economy following 1952 based on the 1943 - 1952 standard of economic equilibrium.

The dislocation of 3.9 trillion dollars of earned income and the unjustifiable cost of 1.6 trillion dollars in excessive interest total 5.5 trillion dollars, within a few billion, of the total increase in the public and private debt in the exact same interim.

I really don't care what my critics say about this conclusion. It is self-evident to anyone with a knowledge of eighth grade arithmetic that this wouldn't have happened had we maintained the standard of equilibrium and income share that we established from 1943 to 1952. This was the period when we monetized our renewable wealth and structured our society on true value of our raw materials.

Not only that, but it is common knowledge that we had the capability of 'managing' our economy then and we used it well in achieving economic equilibrium consistently for ten years. We still have this capability today. It is already law and can be implemented by the Secretary of Agriculture with the stroke of a pen, with the consent of the President. It can be re-instated almost immediatel

However, if we would decide that we want to do this again, and that we can do it, we have two new problems that we did not have in 1940. The first and most formidable is the unprecedented 6 trillion dollar public and private debt, which is a claim on future income. In addition to the debt, we will have the added cost of carrying this debt until it is paid which will increase the total cost of liquidation to more than 30 trillion dollars in the next fifty years at 10% interest per annum.

The second problem stems from the fact that the 1940 - 1943 initial upsurge took place when the economy was in approximate equilibrium and it could readily tolerate regulations which were largely not needed because the economy was already functioning in an almost ideal manner. Whereas, at the end of 1983 and currently, the economy of the United States is so seriously distorted and out of balance, so far, that similar programs today would only compound already serious problems. Nothing is likely to work now until some prior standard of equilibrium is again achieved. It is my conviction that equilibrium will restore rather quickly with the re-establishment of the economic policies that prevailed in the 1943 - 1952 period. A 90% price support policy on raw materials would increase the Gross National Product in America to 5.6 trillion by 1986, and, under the current tax structure, service public and private debt with earned operating profits.

What can we do about it?

I would like to submit three questions to you.

(1) Are we capable, at this point, of recognizing the 'missing link' that could have prevented excessive debt creation at the outset which might lead us to economic order?

(2) If it is true, as recounted in history, that it was possible to buy the same basket of food in 1913 for approximately the same dollar outlav that it cost in 1814, would a comparison with the economic operation of that period in contrast to the period since 1913 provide us with the knowledge to re-order our economy today?

(3) Would you agree with me that if it becomes necessary or unavoidable to collapse the economy to restore equilibrium and economic order, we must still find the answer to the causal factor of existing economic disorder in order to move the economy forward again to renewed economic opportunities inherent in a balanced economy similar to 1940 - 1943 following another depression?

I would offer one suggestion in closing. The solution to the domestic economic problems of the United States may very well be the solution that will solve the economic problems of the Third World as well.

"Every man is worthy of his hire."

Thank you for your consideration and time.

Yours truly,

Fred Huenefeld, Jr.

FHjr/rh

(Attachments follow:)

NATIONAL ORGANIZATION FOR RAW MATERIALS
Fred Huenfeld, President
P.O. Box 4430
Monroe, Louisiana 71211

September 10, 1985

Congressman Ed Jones , Chairman
Conservation, Credit, Rural
Development Committee. U. S. Congress.

"THE REAL STORY"

The attached comparison of "The percentage of National Income earned by Agriculture annually, as Realized Net Farm Income, from 1929 to 1984", with "The total loans (exclusive of government bonds and other investments) in ratio to total deposits (of all commercial banks in the U.S.), form 1929 to 1984" is an abstract of much more detailed information. The National Income figures are obtained form the publication "Economic Indicators" published by the Department of Commerce for the Joint Economic Committee of the Congress. The commercial bank totals are obtained form the monthly publication of the Federal Reserve Bulletin, published by the Board of Governors of the Federal Reserve System, Washington, D.C.

This study began in 1948 when the "Economic Indicators" was first made available to the public, and has continued every year since 1948.

It has been proven to be a remarkably accurate economic indicator from which long range extrapolations could be made by simple arithmetical projections. Only when farm raw material prices were supported at a floor of 90% of parity, from 1942 through 1952, did the economy maintain equilibrium with reasonable prosperity in every sector, and a high level of financial solvency.

With the decline in "agriculture's share" of national income, after 1952, the ratio of loans to deposits in the entire commercial banking system increased predictably to all time record high levels in 1984.

As the share of national income earned by agriculture declined from an average of 6.76% from the end of 1942 through the end of 1952, to an historically low level of .52%, the loans to deposit ratio of all U.S. commercial Banks rose from an average of 26.6% (1943-1952) to 82.8% in 1983. While agriculture's share of national income declined 92.3% in 31 years following 1952, the liquidity of the commercial banking system declined 67.9%. Another way of stating this decline in the liquidity of 'all' commercial banks in the U.S. is to say 'illiquidity' increased 111.3%.

The loan to deposit ratio increased to a new all time high record of 89.6% at the end of 1984. The highest level prior to World War II was in 1920, when it reached 80.7%.

For comparative purposes, it needs to be stated that this study excludes other commercial bank investments such as U.S. government bonds, etc. The highest level of loans and investments, in ratio to total bank deposits, prior to World War II was 1920 also, when loans plus investment totaled 105.4% of commercial bank deposits. At the end of 1984, the new total of loans plus investments in ratio to deposits is an all time record high of 114.3%.

Now if you will let me, I will walk you through this comparative study while I make observations on the various periods. You will note that I do not project nor extrapolate from this information. My observations are pure "hindsight". However, in the past I have made 'predictions' based on this information as it has developed since 1948, and as previously stated they have been remarkably accurate.

First take note of the fact that agriculture's share of national income was 7.2% in 1929 (7.2¢ out of every 100 cents of national income earned). In 1932, the worst year of the depression for the agricultural economy, it dropped to 4.9%, and then rose again to 6.3% in 1933, never to drop below 4.9% again until 1953, when the so-called 'rigid' 90% of parity price support program of 1943 through 1952 became the 'flexible' parity farm program. It is the 'flexible' parity farm programs since 1952 which have permitted, if in fact they have not 'orchestrated', the 92.3% decline in agriculture's share of national income since 1952.

Following the collapse of the economy in the fall of 1929, you will note that agriculture's share of national income was fairly constant, ranging from 4.9% to 7.4% in 1942. However the loan to deposit ratio declined steadily from 1929 to 1942, as the banking system liquidated loan losses, and suffered from declining deposits due to a 50% decline in total national income from 1929 to 1932.

Then from 1942 through 1952, agriculture's share of national income averaged 6.76% for ten years. The improved profit level from 1940 to 1943, an increase of 110% in total national income in 3 years, was evenly divided by the 6 sectors of the economy. It did not cause inflation because it was evenly divided. It did set the stage for the implementation of the Steagall Amendment to the War Production Act of 1942, which implemented many economic controls, and placed a rigid 90% of parity price support program firmly in the economy until "two years after the war was officially ended".

You will note the loan/deposit ratio of the commercial banking system continued to decline, as new profits increased bank deposits at a more rapid rate than loans increased. At the end of 1944 the entire commercial banking system of the United States could find a market in loans to individuals, partnerships, and corporations for only 16.9c out of each 100 cents of deposits.

At this point interest rates were very low. The Federal Reserve Bank rediscount rate was at 1% per annum. Thirty day U.S. Treasury Bills were yielding less than 1% per annum interest return to the investor. The very favorable economic climate created by relatively high farm raw material prices, approximate full employment, and the absence of inflation not only generated the income and profits to consume all of the available production for cash, it also created enough surplus income and profits to purchase all of the government bonds that were sold by the U. S. Government to fight and pay for World War II. Had taxes been levied on the excess profits earned during this period, the United States could have paid cash for the cost of World War II.

This rather remarkable period of economic equilibrium is being ignored by analysts today and the prosperity that 90% of parity farm prices generated during this period, together with other favorable economic factors, is being attributed to World War II. There is no magic in a war that in itself can create prosperity. The overall economy must be in balance, and excesses must be avoided by simple rules and regulations that apply to everyone, which prevailed during the 1943 through 1952 period.

The proof of this is the subsequent Vietnam War which was fought from 1965 to 1975. As wars go, the Vietnam war was the most expensive war the United States has ever fought; expensive from a financial point of view, expensive from th point of view of human suffering and loss of life, and the loss of credibility by the United States in the eyes of the rest of the world. No war in history, including World War II, can compare with the magnitude of expenditure, inflationary impact, loss of earned income and profits, and increase in public and private debt. If wars make a nation prosperous, then the Vietnam War should have contributed more to prosperity, than World War II.

#4 "The Real Story"

A few of the relevants facts are that where we increased the public and private debt in World War II by $200 billion dollars, we increased the public and private debt during the Vietnam war $2 trillion dollars.

In 1968 the commercial banking system of the nation experienced its first post World War II 'debt crisis'. The banks were lending money and buying government bonds at a more rapid rate, then new deposits were being created from income and profits in the nation.

On August 15th, 1971 the United States was forced to abandon the gold standard which set the stage for a more or less unlimited increase in the 'money supply' and rapidly rising inflationary pressures.

By 1980 the Federal Reserve Bank lost control of the cost of interest in the financial system, which it had kept at an 'unrealistically' low level prior to 1980. The fact that interest rates didn't rise gradually as the resources of the commercial banking system were being used up from 1952 through 1980, caused a lot of people to borrow excessively, only to get caught when interest rates exploded out of control in 1980 and subsequent years.

The ensuing inflationary expansion following 1971 until about 1962 caught a lot of people off guard, and the subsequent decline in the economy, accentuated in the agricultural economy because agriculture did not experience commodity inflation, though farm land prices rose rapidly and unrealistically after 1971, and until 1982. The subsequent decline in farm land values, and the relatively flat farm prices for farm commodities since 1952, has placed the agricultural economy in a vise, which has tightened every year since 1952, and excrutiatingly since 1982.

It became apparent in 1962 that the long term trend in the over-all economy was causing commercial bank loans to rise at an average rate of two percentage points per year more rapidly than deposits. That determination was made from information available in the 'Economic Indicators' and the 'Federal Reserve Bulletin' which was readily available to business and government entities from 1945 to 1962. A simple extrapolation of these data indicated that the commercial banks would have a ratio of loans and investments equal to 100% of deposits by 1972 or 1973. Surely enough, on December 31, 1973 the loan and investment to deposit ratio was 100.3%. When this ratio reached 102.7% on July 30th, 1929, it resulted in a depression which began on October 29th, 1929, just 3 months later. It was, at least, a major contributing factor in the depression of the 1930s.

#5 "The Real Story"

Based on this projection, a national banking association contacted various departments of the Federal Government in the late summer of 1962. This committee talked to the Federal Deposit Insurance Corporation, to the Council of Economic Advisors, to the Chairman of the House Banking and Currency Committee, and to the Secretary of Agriculture. In every case the information was viewed as accurate, but we were told that we "were drawing an erronious conclusion" that the realtionship between agriculture's share of national income and the loan/deposit ratio of commercial banks was "purely coincidental."

This national banker's association subsequently went on record in 1966 when it published an account of the findings of this committee of rural bankers, which predicted more than 100% of loans and investments in ratio to deposits in 1972 or 1973, but went on to predict that "if this circumstance comes to fruition, and other circumstances similar to July 30th, 1929 prevail, that there would be widespread bank failures by 1975 or 1976".

It is evident as a matter of hind-sight that widespread bank failures did not occur in 1975 and 1976. What this group didn't anticipate, and in fact couldn't even contemplate in the early 1960s, was the fact that the United States Government would abandon the 'gold standard' on August 15th, 1971. Never-the-less, and inspite of an injection of more than $4 trillion of public and private debt in an effort to sustain the economy of the United States, by 1984 and 1985, just 10 years and $4 trillion dollars away from the prediction of "wide-spread bank failures by 1975 and 1976", banks are beginning to fail in numbers that have not been exceeded since the depression of the 1930s.

We would like to believe the foregoing would be sufficiently apparent to others. as well as ourselves, to cause a re-examination of national monetary and farm policy on a broad scale. This is quite obviously not the case in spite of the miserable economic performance of the U.S. economy since 1952, and particluarly since 1971.

One simple illustration should suffice. From the time this country declared its independence from England, to the end of 1952, 174 years, the United States accumulated a total of $550 billion of public and private debt. In simple terms this means that we failed to generate enough income and profit during that 174 year period, to pay cash for $550 billion of goods and services that we used, but could not afford. So we borrowed $550 billion. In doing so we placed a claim on future national income, out of which this debt would have to be repaid, plus the incremental cost of interest on this debt. If this debt was not repaid, at 10% interest per annum, it would double every 8 years.

#6 "The Real Story"

Now contrast the situation just described with what has happened in the United States since 1952.

In just 34 short years, barley more than one generation, the United States has incurred an additional public and private debt of $6.65 trillion.

Using the same analogy on this $6.65 trillion increase in public and private debt in the last 32 years to the end of 1984, our nation failed to generate enough income and profits to be able to pay cash for $6.65 trillion of goods and services that we used during this period, which we could not afford. So we borrowed an additional $6.65 trillion. In doing so we placed a claim on future national income, from which this debt will have to be repaid, plus the incremental cost of interest on this debt. If this debt is not repaid promptly (which is clearly impossible) at an interest carrying cost of 10% per annum, it will double in 8 years.

According to Henry Kaufman of Solomon Brothers the total public and private debt today is $7.2 trillion, which is made up of the $550 billion incurred prior to 1952, and $6.65 trillion incrurred since 1952 and up to and including 1984.

This is where we are today and we are still ignoring the very valuable lesson which should have been learned from the almost perfect function of the economy under extreme stress, from the end of 1942 through 1952, when "farm commodity prices averaged 100% of parity with the average cost of all other goods and services in the economy."

What is parity? Parity is economic equilibrium, during which every sector of the economy can trade the product of an hour of labor, for the product of an hour of labor in every other sector, in the 'long term'.

Needless to say perhaps, because it is a matter of record, but the farm programs from 1932 to 1952, which included the 1943 to 1952 parity period, did not cost the government of the United States, nor the taxpayer, even one red cent in farm subsidy payments. In fact it made the government a profit of $13,000,000.00 according to Congressman Cooley, the Chairman of the House Committee on Agriculture in 1964.

Dr. Simon Kuznets, Professor Emeritus at Harvard University, is the world's leading authority on growth measurements. His pioneering work in that field underlies the whole concept of 'gross national product' and 'national income'. In 1971 he won the Nobel Prize in economic science for his growth studies. He was the originator of 'Economic Indicators' which was developed in the late 1930s and early 1940s for

for the use of the Federal Government agencies in planning and analyzing the national economy. It was, as stated earlier, made available to the public in 1948, and it is the basis for this entire paper, and nearly a half century of study and analysis by people outside of government.

Why hasn't it been recognized for the very accurate long term economic indicator that it is? We don't really know, but we are suspect from references made to it by conventional economists, that it would make a drastic change in economics as it is being taught, and as it has been used and is being used in recent history.

To support this conjecture, we quote from an interview with Dr. Kuznets in the early 1970s.

> "A country our size and our weight in the world has to act in a much more planned and systemateic way than to rely on these sudden reversals, announced suddenly. I mean this is, in a sense, exagerating the short term, but you see the problem is a fickle one because there are very few institutions in our government that have the responsibility for the long run.
>
> "In a sense, the only one that does have is the Supreme Court because it presumably passes on the validity of legislation in terms of long established and you might say almost permanent criteria. But we don't have a Supreme Court you see, in economic matters. Congress has never wanted to have in the executive branch a body concerned with long term growth... The Council of Economic Advisors has become more and more concerned with the short run, rather than less, because it has become more and more a direct advisor to the President, rather than a permanent body of the Civil Service, and it changes with the President. There is no central body within government that has a kind of intellectual responsibility of supervising and observing the whole thing and keeping track which could be sufficiently established and free from short term pressures...
> "I mean that it all becomes somehow the occupation of enthusiasts and amatuers, ane yet if the government is to accept responsibility for long range development of the country it just can't continue writing annual reports and then set up ad hoc commissions to deal with problems when suddenly the problems decend on their heads and have nobody to take a longer view...

#8 "The Real Story"

"Soon the government in this country and in other countries will have to attempt to start preparing reports on growth, not an annual economic report of the President which can't help but cover a single year, but to have some authoritative periodic reporting of what happened in the economy in the last year, of what happened to it in the last ten to fifteen years, with some interpretation as to how much as to what happened was temporary and how much is lasting, and at the same time go more deeply into the qualities as to what happened. Now whether this will ever be possible in our society with the President changing every four years and trying to take credit for two or three years in which he is presumably affecting the conditions of the country, I don't know. But it is a problem, not only from the standpoint of economic growth of this country, but from the standpoint of political organization. The dangers largely lie in acting on what may turn out to be the wrong answers for too long."

Dr. Kuznet's final statement sums up very nicely what we would be inclined to observe on the manner in which we have handled our economy during the last 34 years. There is little doubt but what we have invited all of "The dangers inherent in 'acting on what may turn out (are now proven) to be the wrong answers for too long."

To suggest that we can now restore farm prices to 100% of parity and restore the unprecedented dislocation of national income to the 'individual sector's share' that is essential to relative prosperity in all sectors, and financial solvency, at this point would be completely irresponsible. But to suggest that the economy of the United States will never again achieve economic equilibrium, relative prosperity in all sectors, and financial solvency on a sustained long term basis, without farm prices at 100% of parity is axiomatic. It is written in the history of the United States since the turn of the century, as it is written in the history of the French Revolution almost exactly 200 years ago and on enumerable occasions prior to that.

It was Seneca (3BC - 62AD) who stated.. "Our posterity will wonder at our ignorance of things so plain."

Fred Huenefeld Jr.

V.E. Rossiter, Sr. ,Analyst
3-15-85

2/27/85

1.25 ASSETS AND LIABILITIES OF COMMERCIAL BANKING INSTITUTIONS Last-Wednesday-of-Month Series

Billions of dollars

Account	1983	1984								1985	
	Dec.	May	June	July	Aug.	Sept.	Oct.	Nov.ʳ	Dec.ʳ	Jan.ʳ	Feb.
ALL COMMERCIAL BANKING INSTITUTIONS[1]											
1 Loans and securities	1,680.6[2]	1,736.9	1,764.1	1,765.3	1,784.5	1,798.9	1,822.7	1,822.7	1,864.0	1,854.5	1,874.4
2 Investment securities	7.6	382.0	381.2	378.2	376.2	377.3	375.2	374.4	377.5	381.3	382.2
3 U.S. government securities	6.1	247.7	248.2	246.5	243.5	243.5	241.2	240.4	242.5	244.8	247.9
4 Other	1.3	134.4	133.0	131.7	132.7	133.8	134.0	133.9	134.9	136.4	134.3
5 Trading account assets	0	18.8	14.6	15.7	20.0	20.9	22.5	21.9	22.9	24.2	27.6
6 Total loans	1,249.3[2]	1,356.1	1,368.3	1,371.4	1,388.4	1,400.6	1,424.9	1,426.4	1,463.7	1,449.1	1,464.6
7 Interbank loans	111.4[2]	124.7	122.8	118.6	127.1	123.3	126.1	122.6	126.9	125.3	128.7
8 Loans excluding interbank	1,137.9[2]	1,231.4	1,245.5	1,252.8	1,261.2	1,277.3	1,298.8	1,303.8	1,336.8	1,323.8	1,335.9
9 Commercial and industrial	419.4	447.3	452.9	454.4	455.2	459.9	467.7	468.7	476.8	470.6	477.3
10 Real estate	332.6[2]	350.3	354.6	356.8	361.8	366.7	369.8	374.4	377.7	380.5	382.5
11 Individual	217.6[2]	228.4	232.8	235.2	240.0	243.4	247.1	249.6	255.5	257.6	258.1
12 All other	168.5[2]	205.4	205.2	206.3	204.2	207.3	214.2	211.1	226.8	215.1	218.0
13 Total cash assets	219.6	202.5	185.6	179.1	177.3	176.0	188.0	188.4	201.9	187.8	189.2
14 Reserves with Federal Reserve Banks	23.5	18.6	19.1	19.4	17.6	8	19.1	20.4	20.5	20.9	19.6
15 Cash in vault	23.6	22.3	21.8	21.6	22.2	21.6	21.4	23.9	23.3	21.9	21.8
16 Cash items in process of collection	73.2	76.4	63.7	60.2	60.7	63.2	70.2	66.5	75.9	66.9	68.7
17 Demand balances at U.S. depository institutions	99.5	34.8	30.8	29.3	29.5	31.2	32.0	30.9	34.5	30.9	32.3
18 Other cash assets		50.4	50.1	48.6	47.5	59.3	46.3	46.7	47.7	47.3	46.7
19 Other assets	193.6	200.1	205.9	205.4	204.7	215.3	215.7	204.2	210.9	205.8	209.1
20 Total assets/total liabilities and capital	2,093.0	2,139.5	2,155.5	2,149.7	2,166.5	2,190.2	2,226.3	2,215.3	2,276.7	2,248.1	2,272.7
21 Deposits	1,508.9	1,541.3	1,532.9	1,535.5	1,539.0	1,549.9	1,578.9	1,578.2	1,631.2	1,604.5	1,617.9
22 Transaction deposits	374.6[2]	462.6	465.9	441.4	440.0	442.3	462.7	453.1	491.1	456.9	459.4
23 Savings deposits	457.2[2]	371.6	360.5	[illegible]	365.1	354.9	371.1	378.1	386.3	400.0	406.8
24 Time deposits	677.1	707.2	717.4	725.6	734.0	742.7	745.0	747.0	753.8	747.5	751.8
25 Borrowings	273.2[2]	292.8	292.8	292.0	301.5	307.1	314.3	298.8	304.1	306.7	309.0
26 Other liabilities	166.4[2]	187.8	187.9	182.0	183.8	187.0	189.2	193.5	195.2	188.4	196.8
27 Residual (assets less liabilities)	147.3[2]	137.6	141.9	140.2	142.1	146.2	144.0	144.8	146.2	148.6	149.0
MEMO											
28 U.S. government securities (including trading account)	254.1[2]	260.1	256.3	255.6	255.1	255.3	256.3	255.2	256.9	261.8	269.4
29 Other securities (including trading account)	177.2[2]	140.7	139.3	138.3	141.0	142.7	141.5	141.1	143.4	143.6	140.4
DOMESTICALLY CHARTERED COMMERCIAL BANKS[3]											
30 Loans and securities	1,591.3[2]	1,663.2	1,671.0	1,676.7	1,688.4	1,708.0	1,728.5	1,726.7	1,765.4	1,758.5	1,774.6
31 Investment securities	n.a.	375.3	374.5	371.2	369.1	370.0	367.9	367.5	370.5	374.0	374.9
32 U.S. government securities	n.a.	242.5	243.1	241.4	238.5	238.5	236.1	235.8	237.9	240.0	243.1
33 Other	n.a.	132.8	131.4	129.8	130.7	131.5	131.8	131.6	132.6	134.0	131.7
34 Trading account assets	n.a.	18.8	14.6	15.7	20.0	20.9	22.5	21.9	22.9	24.2	27.6
35 Total loans	1,167.6[2]	1,269.2	1,281.8	1,289.8	1,299.4	1,317.0	1,338.0	1,337.3	1,372.1	1,361.3	1,372.1
36 Interbank loans	87.0[2]	96.2	94.7	95.2	97.6	100.0	103.3	96.1	102.8	100.6	101.0
37 Loans excluding interbank	1,080.6[2]	1,172.9	1,187.1	1,194.6	1,201.8	1,217.1	1,234.7	1,241.2	1,269.3	1,260.7	1,271.1
38 Commercial and industrial	381.3[2]	407.4	412.9	414.0	414.5	418.8	423.0	424.7	430.2	426.2	432.0
39 Real estate	327.2	346.1	350.5	353.1	358.0	362.4	365.5	369.1	372.1	374.9	377.1
40 Individual	217.4	228.3	232.6	235.1	239.8	243.2	246.9	249.4	255.3	257.4	257.9
41 All other	154.6[2]	191.1	191.1	192.4	189.6	192.6	199.3	198.0	211.7	202.2	204.1
42 Total cash assets	207.0	190.7	173.2	166.7	165.9	164.0	176.6	176.8	190.3	175.7	177.8
43 Reserves with Federal Reserve Banks	19.9	17.4	18.4	18.0	16.7	.1	17.1	19.7	19.2	20.2	18.7
44 Cash in vault	23.4	22.3	21.8	21.6	22.2	21.6	21.4	23.9	23.3	21.9	21.8
45 Cash items in process of collection	73.0	76.3	63.5	60.1	60.5	63.0	69.9	66.3	75.7	66.7	68.5
46 Demand balances at U.S. depository institutions	90.8	33.5	29.4	27.9	28.2	29.7	30.7	29.4	32.9	29.5	31.0
47 Other cash assets		41.3	40.1	39.2	38.3	49.6	37.3	37.5	39.3	37.3	37.9
48 Other assets	150.4	139.0	141.5	138.9	140.6	145.6	147.9	139.7	142.1	137.5	138.8
49 Total assets/total liabilities and capital	1,948.7	1,992.9	1,985.7	1,982.3	1,995.0	2,017.6	2,053.1	2,043.2	2,097.8	2,072.6	2,091.2
50 Deposits	1,468.1	1,501.7	1,492.5	1,495.4	1,500.3	1,510.9	1,539.1	1,538.0	1,587.8	1,561.8	1,573.7
51 Transaction deposits	368.5[2]	456.2	459.6	434.8	433.7	435.9	456.2	446.8	484.5	450.6	452.9
52 Savings deposits	456.6[2]	370.7	368.6	367.5	364.2	363.9	370.1	377.1	385.2	398.9	405.6
53 Time deposits	643.0	674.9	684.3	693.1	702.4	711.1	712.8	714.1	718.1	712.3	715.2
54 Borrowings	214.1[2]	232.5	229.6	228.0	236.0	243.5	251.3	240.9	243.1	240.5	247.0
55 Other liabilities	122.3[2]	123.9	124.4	121.5	119.3	119.7	120.5	122.3	123.5	118.5	124.3
56 Residual (assets less liabilities)	144.1[2]	134.8	139.1	137.6	139.3	143.4	142.1	142.0	143.4	145.8	146.2

115.8%

90.25%

DEPOSITS

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[1] Commercial banking institutions include insured domestically chartered commercial banks, branches and agencies of foreign banks, Edge Act and Agreement corporations, and New York State foreign investment corporations.

[2] Data are not comparable with those of later dates. See the Announcements section of the March 1985 BULLETIN for a description of the differences.

[3] Insured domestically chartered commercial banks include all member banks and insured nonmember banks.

NOTE. Figures are partly estimated. They include all bank-premises subsidiaries and other significant majority-owned domestic subsidiaries. Loans and securities data for domestically chartered commercial banks are estimates for the last Wednesday of the month based on a sample of weekly reporting banks and quarter-end condition report data. Data for other banking institutions are estimates made for the last Wednesday of the month based on a weekly reporting sample of foreign-related institutions and quarter-end condition reports.

That percentage share of National Income Earned by Agriculture annually, as realized net farm income, from 1929 to 1984.

The Total Loans (exclusive of Government bonds and other investments) in ratio to total Deposits, from 1929 to 1983.***

***All Banks - U.S.A.

		Percent of National Income	Loans in ratio To Deposits	
	1929	7.2%	68.9%	
	1932	4.9%	53.0%	
	1933	6.3%	47.2%	
	1939	6.2%	28.3%	
	1940	5.5%	27.2%	
90% farm price floor	1941	6.2%	30.4%	
	1942	7.4%	21.6%	
	1943	7.1%	18.1%	
WW II	1944	6.6%	16.9%	Record low loan/deposit ratio
	1945	6.9%	17.4%	
	1946	8.3%	22.4%	
	1947	7.8%	26.4%	
	1948	8.0%	29.7%	
Post-war Parity	1949	5.9%	29.6%	
Period	1950	5.8%	33.7%	
	1951	5.9%	35.0%	
	1952	5.3%	36.6%	Korean War
End of 90% Price Sup.	1953	4.3%	38.3%	
	1954	4.2%	38.2%	
	1955	3.5%	43.0%	
	1956	3.2%	45.7%	
	1957	3.0%	46.6%	
	1958	3.6%	45.5%	
	1959	2.7%	50.4%	
	1960	2.8%	51.2%	
	1961	2.8%	50.2%	The Vietnam War did not
	1962	2.7%	53.5%	provide the prosperity
	1963	2.5%	56.7%	of WW II. The 90% of
	1964	2.1%	57.2%	parity farm price
	1965	2.3%	60.7%	'floor' was absent.
	1966	2.2%	61.8%	
	1967	1.97%	59.7%	
	1968	1.8%	61.1%	The First Debt Crisis
Vietnam War	1969	1.9%	67.9%	
	1970	1.8%	65.2%	
	1971	1.7%	64.5%	Gold Standard abandoned
	1972	1.9%	67.3%	
	1973	3.0%	72.6%	Loan & Investment to Deposit
	1974	2.3%	73.4%	Ratio reaches 100.3% of depo.
	1975	2.0%	69.5%	June 30, 1929=102.7%
	1976	1.4%	71.0%	
	1977	1.2%	75.5%	
	1978	1.5%	71.7%*	
	1979	1.6%	77.4%*	****Loan & Investment
	1980	1.0%	71.7%*	to deposit ratio
	1981	1.3%	75.7%*	restoration.
V.E.Rossiter,Sr.	1982	0.89%	73.5%*	
Analyst	1983	0.52% Historic Low Inc.%	82.8%**	**Revised data 3-1-85
3-15-85	1984	0.96% Record high L/D Ratio	89.6%**	*Data revised 1978-83
	2/27/85		115.58%****	

TESTIMONY OF
EASTERN IDAHO PRODUCTION CREDIT ASSOCIATION

Eastern Idaho Production Credit Association is headquartered at Pocatello, Idaho and part of the Twelfth Farm Credit District of Spokane, Washington. The territory served by Eastern Idaho Production Credit Association (EIPCA) encompasses the eastern and southern portions of Idaho, and also a portion of western Wyoming. EIPCA was chartered on January 6, 1934 under the Farm Credit Act of 1933 and has operated as a farm lender for over fifty years. EIPCA's present president and general manager, J. Elden Hill has served the Association continuously for over thirty-four years. EIPCA is one of the larger associations both geographically and in term~~s~~ of loan volume and capital assets.

EIPCA has long been and is now a strong supporter of the farm credit system, and well aware of the seriousness of the financial problems facing not only the Twelfth District but the entire farm credit system, and genuinely desires to work to strengthen and improve the system.

Financial stress is not new to EIPCA. The Association experienced a substantial single-loan loss over a decade ago, and in 1975 received approximately $1.4 million of loss-share money from other Twelfth District production credit associations, which was later repaid in full. In addition, in recent years Eastern

Idaho Production Credit Association contributed approximately $350,000.00 to two Twelfth District associations which later went into liquidation, none of which has been or will be repaid.

Serious financial difficulties in the Twelfth District Federal Intermediate Credit Bank became evident and major district level management changes were made in the summer of 1983. Before year end four PCAs were placed in liquidation, including Southern Idaho Production Credit Association. At the request and urging of the Twelfth District FICB in December, 1983 EIPCA acquired the assets of Southern Idaho PCA consisting of physical assets and approximately $85 million of loans, and expanded its operations to encompass the territory formerly served by Southern Idaho PCA. As a result EIPCA has acquired considerable first-hand knowledge and experience with the overall impact that rapid expansion and personnel, policy and other management changes have on borrower-members, and the resulting loss of loan volume.

In late 1984 a proposal was presented to the Twelfth District PCAs for consolidating the remaining twenty-six associations into a nine PCA configuration which the District felt would result in more efficient operations. The recently expanded territory of EIPCA would have constituted one of the nine associations. The proposal was acceptable to the PCAs, however, was rejected by the Farm Credit Administration. FCA determined that the financial condition of the District had deteriorated such that an infusion of substantial capital was necessary. By year end 1984 another four PCAs in the District were placed in liquidation. This qualified the Twelfth District FICB for system assistance.

In March, 1985 $25 million was made available to the Spokane FICB on an interim assistance basis to allow time for the formulation of a long term assistance package for the District. About $2 million of the interim assistance funds were utilized. Conditions of long term assistance required that the District maximize risk taking ability, provide economies of service and self-help to the maximum extent possible. A plan was devised to merge all PCAs into a single district wide "super" PCA and all Federal Land Bank Associations into a District wide "super" FLBA. This plan required the affirmative vote of a majority of the stockholders of each Association, in accordance with the provisions of the Farm Credit Act.

Following a study of the plan of merger the Board of Directors of EIPCA concluded they could not recommend that EIPCA stockholders vote for the single "super" association merger plan. The Directors felt the merger plan did not address the problems and needs of the FICB and the PCAs of the District, would cause needless disruption to efficient and viable associations and ultimate loss of needed loan volume and that if used as a model by other Districts, such a plan would subject the farm credit system to serious jeopardy from greater losses. Also EIPCA was concerned that the merger plan was legally flawed, and that the proposed financial assistance plan was inadequate and would likely add additional financial stress to the District. The views of EIPCA were and are similar to the views expressed by the Idaho Congressional delegation in the letter attached as Exhibit 2.

The merger plan was submitted to association shareholders at special meetings held throughout the District in late June and early July, 1985. The stockholders of Eastern Idaho Production Credit Association rejected the proposal with over fifty percent of the stockholders voting, and over eight-one percent of those opposing the "super" PCA.

In early August, 1985 the Board of Directors of the Twelfth District FICB adopted a Resolution approving an Amended Plan of Merger which has since been submitted to the stockholders of twenty-one PCAs in the District, excluding however the stockholders of EIPCA. The amended merger plan which is being zealously pursued is similar to the plan earlier presented to and rejected by EIPCA stockholders, however, contains additional features which are of grave concern to EIPCA. The amended plan would again create a single "super" association for the entire district, not just including the territory of those PCAs voting on the plan, but also would include the entire territory served by EIPCA.

Attached Exhibits 9, 10 and 11 evidence the efforts of EIPCA to avoid overlapping of its chartered territory. Exhibit 11, consisting of a letter dated August 30, 1985 to FCA Governor

Donald E. Wilkinson in response to an invitation to detail the legal and policy concerns of EIPCA, outlines the main thrust of the present position of EIPCA with respect to the Amended Plan of Merger.

Recent announcements from the Farm Credit Administration bear out the earlier concerns of EIPCA and many others that the financial crisis facing American agriculture was much greater than projected when the original and amended Twelfth District merger plans were formulated. The Amended Plan has even greater potential for harm not only to EIPCA but the Twelfth District. EIPCA respects the right of other associations to pursue voluntarily merger under existing provisions of the Farm Credit Act and the likely benefit to some associations. We submit, however, that the revised plan which would allow all remaining PCAs to merge "substantially as originally proposed" with District wide territory completely overlapping the chartered territory of EIPCA "so that it will compete . . . with Eastern Idaho PCA", (excerpts from page 1 of attached Exhibit 8) reflects a concept totally foreign to the intent of the Farm Credit Act and contrary to provisions of the Act and promulgated regulations.

EIPCA must vigorously oppose implementation of a plan which allows the overlap of its territory and direct head-to-head competition between the two associations. Territorial overlap can only lead to greater financial stress, not only to EIPCA but also the other association. This seems an astonishing "solution" to problems involving severe financial weaknesses in the Twelfth District.

EIPCA recognizes the extreme seriousness of the present credit crisis and quite frankly anticipated the recent recognition by the Farm Credit System of the need for financial assistance from the Federal Government while at the same time looking to the system's own reserves and resources to the maximum extent possible. Such must be done however in a manner that insures that individual associations are not only able to survive but to operate efficiently and competitively with commercial lending institutions.

The organizational changes currently being proposed in the Twelfth District with respect to the overlap serve no useful purpose. The main stated purpose for the overlap is to provide one-stop credit service throughout the entire District. As noted in attached Exhibits 10 and 11 EIPCA has repeatedly expressed its commitment to one-stop credit and pledged willingness to cooperate in its implementation, immediately in 5 Idaho cities in which offices are located, and hereafter work to implement one-stop service throughout the rest of its chartered territory.

Given the dramatic announcement from Governor Wilkinson last week, undoubtedly Congress soon will be called upon to consider a government financial assistance plan for the ailing Farm Credit System, and to consider amendments to the Farm Credit Act and other legislation necessary to an assistance plan.

Congress must properly insist on control measures to insure that the system utilizes its own resources to the maximum extent possible to minimize the assistance dollars needed.

Root causes of the present dilemma should be carefully examined, so that legislative action taken reflects positive and constructive steps to stabilize and improve the system long term, and that hastily conceived and unnecessarily radical changes be avoided which would ultimately weaken the Farm Credit System.

EIPCA sincerely and respectfully submits that the present financial crisis facing the Farm Credit System is not the result of major defects in the organizational structure of the system. The present system has served American agriculture well for over 50 years during prosperous times as well as times of severe depression. The strength of the system has resulted from the fundamental concept of separately chartered associations with the grass roots input and local control, with proper and constructive supervision from the District and Farm Credit System levels. EIPCA respectfully submits that a highly centralized "national farm bank" will neither serve the best interests of or be supported by the majority of American farmers and ranchers.

Changes have occurred and will continue to occur, and will require sensitivity and response to the need to meet the challenges of a dynamic agriculture -- we have a saying in Idaho -- "if it breaks fix it, if it works leave it alone". In examining the various suggestions for revamping the Farm Credit

System careful consideration must be given to the probable bottom line impact on the borrower-members.

Care should be taken to make certain that solutions address the real problems, including the lending excesses of the 1970's. Change is essential; outside capital must be obtained; controls need to be imposed to insure better management and supervision; associations financially too weak or geographically too small to be viable operations must be merged; loss share programs need to be broadened and revised to insure the system can quickly utilize and maximize its own resources and reserves; management functions must be consolidated wherever reasonably possible.

Change must occur in a manner that does not unnecessarily disrupt organized, efficient and viable associations. Care must be exercised to insure retention of those features of the Farm Credit System which have been and are now serving the best interests of American agriculture. Changes must not occur in a manner disruptive to the American farmers and ranchers who are the backbone of the farm credit system.

We would request the opportunity to review and supplement the written testimony herewith presented. We express our sincere appreciation for the opportunity to share our experience and views on the current financial crisis facing the Farm Credit System and American agriculture, and our concerns with the response of the Twelfth Farm Credit District to the crisis.

RESPECTFULLY SUBMITTED,

EASTERN IDAHO PRODUCTION CREDIT
ASSOCIATION

2292f:wh

ATTACHMENTS TO WRITTEN TESTIMONY OF EASTERN IDAHO PRODUCTION CREDIT ASSOCIATION

EXHIBIT		
1	(3 pages)	Certificates of EIPCA Charter and territory
2	(2 pages)	Joint letter dated April 26, 1985 from Idaho Senators McClure and Symms and Congressmen Craig and Stallings to CEO of Farm Credit Banks of Spokane
3	(4 pages)	Letter dated May 3, 1985 from CEO of Farm Credit Banks of Spokane in response to Exhibit No. 2
4	(1 page)	Letter from Congressman Larry E. Craig dated June 6, 1985
5	(1 page)	Letter from U.S. Senator Steve Symms dated June 11, 1985
6	(2 pages)	Letter from U.S. Senator James A. McClure dated July 11, 1985
7	(2 pages)	Resolution of Board of Directors of FICB of Spokane dated August 2, 1985 approving amended Plan of Merger
8	(7 pages)	Supplement to Major Disclosure Statement dated August 2, 1985 detailing amended Plan of Merger
9	(1 page)	Letter dated August 8, 1985 from EIPCA to CEO of Farm Credit Bank of Spokane
10	(1 page)	Letter dated August 16, 1985 from EIPCA to CEO of Farm Credit Bank of Spokane
11	(10 pages)	Letter dated August 30, 1985 from EIPCA to FCA Governor Donald E. Wilkinson

(The attached exhibits are held in the committee files.)

This letter of information, and personal testimony is in fact the true story of Theodore and Charlene Reiser (father and daughter of Valentine, Nebraska.

This is addressed to ______________________________.

TOPIC --------- Valentine Production Credit Association
(In Liquidation) and the Farm Credit System

I realize times are changing---. I realize, we, as intelligent citizens of this country have to "change with the times", and try to better ourselves, and our operations for the future. BUT, there are some things that should stay the same thru-out eternity, AND, should not change!!

One of these things, is- HONESTY -- trust and honor between one another! When the time arrives that you can't trust your "banker"-- Something is drastically wrong!! And, that WRONG needs CHANGED!!

What I'm speaking about specifically is the Valentine Production Credit Association (In Liquidation) -- a branch of the Farm Credit System. The eighth district.

My father, Ted Reiser and I are ranchers south of Valentine. We live on the old "homestead", out by Brownlee, Nebraska. My father is 80 years old and has worked hard all of his life, until he retired when he turned 75 because of his eyesight. We bought some additional land 26 years ago in Thomas County (down by Thedford). It was nearly paid off until about 5 years ago, when conditions in the agricultural system sortof "went to hell". High interest rates, cheap cattle, cheap grain, high operating expenses, you all know the story! We changed over from a city bank approximately 8 years ago,to PCA. Our major reason for doing so,was because we thought it was supposed to be owned and operated by local farmers and ranchers, who participated in management and credit advice. We assumed it would be better operated, to understand the needs of the people in agriculture. We assumed WRONG. They advertised that their interest rates were lower, (or at least competitive), and that they were there to help us. Well, let me tell you something, their kind of help isn't what we had in mind. It certainly was NOT honest or understanding!

We are ranchers whose newest tractor was 20 years old, our oldest (which we still used) until they took it away, was 43 years old. Our one and only pick-up is going on 10, so as you can tell we weren't extravagant at all, and always tried to save our pennies, and didn't buy anything we didn't need.

With PCA'S help, we had 18-20% interest in the early 80's, which ran off a good share of their best borrowers. With cattle prices down 5 straight years in a row, and non-competitive interest rates, we've acquired a loss we'll never recouperate from.

(continued)

Page 2

One of the most underminining "tricks" they pulled on us happened in April of 1984. They sent us a letter, -- "said to come in for a visit." At this particular "visit", [illegible] was just me and my father. They told my father that he needed to pledge more security. They asked if he would mortgage some land. Daddy told them that he would mortgage his half of the "South Place", in Thomas County (my half was already mortgaged.) BUT, that he would not mortgage the old "homestead" in Cherry County. They said, "O.K. we'll type it up, come back in next week and sign it. The next week, I was still busy calving, so he and my step-mother went in by theirselves. (Naturally, she had to sign it with him anyway)....... Before I go any further I must tell you that my father is totally deaF in one ear and only has 10% hearing in the other. He is also nearly blind. He can not read, can not pass a drivers test, can not see to watch television. He can see objects in front of him, but not well enough to tell men from women. (in case your wondering he has made me "power of attorney" since this deal.) BUT, Before this, my father trusted his "banker"- as a friend, and a business manager!! When he and my step-mother returned the following week to sign the necessary papers, he ASSUMED the papers were written up as they were discussed the week before. He could not see what he was signing, and they knew it! As for my step-mother, she is a "sweet little old lady" who knows nothing about business, even after she reads it. They just handed her the paper, and said "here, sign here". She signed because because father did, and trusted that everything was written up as was formerly discussed the week before. ------- Several months later, after hearing "rumors" about the P.C.A. and some "WRONG DOINGS" that had happened to other people, that I decided to check it out. My findings were that the mortgage was on the "home place" in Cherry County, and not on the Thomas County land as was discussed. I presented my father with this fact, and asked him if he knew he had signed a mortgage against the "home place", and he said "Hell No"! "I wouldn't do that". When I convinced him that he really had, he just couldn't believe it! He said, "that just isn't the way it was suppose to be." Later on, one day in town, I stopped into the P.C.A. and asked them what the deal was??? They said that the legal discriptions was easier to get for Cherry County, and that all they had to do was to go down town. They ~~also~~ added that they would release it when out SouthPlace was sold, but it never sold. NOW! If P.C.A's procedure wasn't illegal, and deceitful and unscrupulous then I must not know what is! ~~[illegible] trust a banker again? [illegible]!~~

From the very beginning, when we discussed transfering our loan from a commercial bank to ~~[illegible]~~, Valentine ~~Production Credit Association~~ PCA if they would have informed us that there was any possibility at all, OR any RISK at all, in losing the B Stock, we damned sure wouldn't have ~~gotten~~ got a loan with them. NOBODY in their right mind would! All of this just proves to me that P.C.A. has no creditability at all!!!

~~[illegible]!!!~~ They have already ruined us, by closing and liquidating us, which their own negligence and mismanagement, ~~[illegible]~~ caused.

By their own mismanagement

We are NOT asking for a HAND OUT!!! All were asking for is the release of the liability on the B Stock!!!

(continued)

BEST AVAILABLE COPY

Page 3

All summer of 1984, the rumors kept circulating on how the Valentine P.C.A was going to close. Every time that we stopped in the Associations office we would ask if this was true? They always said "Oh NO!", "We're doing fine!" "We're in great shape". By coincidence, just the day before they officially announced it on the radio, that they were closing, we happen to be in town that day and stopped by,-- asked them the same question, and got the very same reply as before!! Lies!! Where was their Fiduciary responsibility???? They signed that security agreement too!!!! P.C.A. Should have never put us in jeopardy in the first place!! Where were the directors we thought were working for us?????

During the last several years, (before they closed), they advised us to go to a yearling operation, they told us to buy 300 yearlings (steers) for the summer, instead of "taking them in", by the month like we usually did. We lost 30,000 dollars on the deal. I call this negligent advice. They wouldn't listen to our "deal" we had penciled out on paper. Are these people suppose to be specialists in farm credit?????

We feel deceived and manipulated by not being informed of the risk of the B Stock. We were given bad advice which caused us damages. We were not informed of the serious financial shape that our association was in. We were lied to about the closing, right up to the very last day before it was announced.! They were dishonest and mislead a blind man, causing him to sign a mortgage on different property than he consented to. They have a "loss sharing" agreement which they have not stood by, which to me is none specific performance. Their conduct has been LESS than legal.

To us, they are the ones that are "POOR" managers!! They were the ones that made several large loans that were not secured!! They mismanaged our Association, and put us in financial trouble. We're getting "nailed" because of their mistakes! We didn t even receive a financial statement for 1983 or 1984. Then, they yell bankrupt, and close their doors, then try to pressure the borrowers into paying back in 60 days what they borrowed over the last 10 years.

Let me ask you this.... If you lived in the city, and owned a home that wasn't paid off and your lender said you've got 60 days to pay off your home in, THEN, on top of that, raised your interest another 10% for the duration of the whole loan--- It's the same difference! Could you pay if off in 60 days?? How would you feel if you had to sell everything you worked 60 years for, and end up with nothing?????!!!

We have lost half of our land, and all of our cattle, and all of our machinery---- thru what we consider unauthorized liquidations. All we want is a release of the liability of the B Stock! Which by rights should be released anyway. That is the least we deserve, after all the "wrong doings" of the Valentine P.C.A. and The Farm Credit System you can't trust. We've had to "tighten our belts" before-- couldn't always get the new shoes you wanted or the new clothes BUT, I never thought I'd see the day we couldn't pay our electric bill or be able to buy groceries-especially after an honests days work!!

SO, WE NEED A CHANGE, ALL RIGHT, --- A CHANGE IN THE FARM CREDIT SYSTEM!!!

SO, PLEASE HELP US.

[illegible] that will work. and - a good farm bill + [illegible] terms

AGRICULTURAL CREDIT CONDITIONS

WEDNESDAY, OCTOBER 30, 1985

House of Representatives,
Subcommittee on Conservation,
Credit, and Rural Development,
Committee on Agriculture,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:05 a.m., in room 1300, Longworth House Office Building, Hon. Ed Jones of Tennessee (chairman of the subcommittee) presiding.

Present: Representatives Weaver, Glickman, Daschle, Stenholm, Tallon, Thomas, Stallings, Coleman, Jeffords, Morrison, Gunderson, Evans of Iowa, and Franklin.

Also present: Representative E (Kika) de la Garza, chairman of the committee; Representatives Hopkins, Stangeland, Combest, and Schuette, members of the committee; Representatives Craig, Bereuter, and Smith of Nebraska.

Staff present: Phillip L. Fraas, counsel; Robert T. Lowerre, associate counsel; Cristobal P. Aldrete, special counsel; Charles Hilty, minority staff director; William E. O'Conner, Jr., assistant minority staff director; John E. Hogan, minority counsel; Mark Dungan, minority associate counsel; Glenda L. Temple, clerk; Bernard Brenner, Robert A. Cashdollar, James W. Johnson, Jr., Fred Clark, and Susan Adkins.

OPENING STATEMENT OF HON. ED JONES, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE

Mr. Jones of Tennessee. Good morning, ladies and gentlemen. The Subcommittee on Conservation, Credit, and Rural Development will come to order.

The subcommittee welcomes each of you here today. We apologize for not having more room for those who are here. We would love to be able to accommodate each and every one who is interested in this vital and important question, but the rooms here just simply do not accommodate that much space for such a meeting.

A policeman is on the door, and I have asked him, when he can, to shift those who leave to some who would like to come in and be heard or to be seen and to listen. And that I am sure he will do.

I do ask that the doors be kept closed in order that the witnesses may be heard by the subcommittee as they give their testimony.

Today's hearing is the third in a series which our subcommittee began last month. The purpose of the hearings have been to gather testimony on the current conditions in our Nation's agricultural lending sector, its problems and proposed solutions. We will meet again tomorrow in continuation of this agenda.

It is my intention to review all testimony and recommendations offered during this series of hearings and to make a decision in the next few days on how the subcommittee should best proceed. We have complete and comprehensive witnesses on the list today that are scheduled to be heard, and also for tomorrow.

It will be difficult to finish these sessions unless witnesses observe a reasonable time limit. I ask that witnesses limit your oral remarks to less than 10 minutes, with the complete understanding that your entire written statement will be included in the record, if you summarize.

We are going to try to be just as lenient as we possibly can with time, but if you will look at the list, you will understand what I mean when I say that.

At this point I will recognize our ranking minority member, Tom Coleman, for any remarks that he might have.

OPENING STATEMENT OF HON. E. THOMAS COLEMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MISSOURI

Mr. COLEMAN. Mr. Chairman, today it is important that this subcommittee is conducting these hearings on the Farm Credit System, particularly in light of the information released last week on the third quarter financial statement and new developments in negotiations with the Farm Credit System, Farm Credit Administration, Department of Treasury, and the Department of Agriculture.

The ~~third~~ quarter financial report for the 37 farm credit banks was released October 23. These results were not much of a surprise to those of us who had been studying the issue for some time and are aware of the agricultural credit problems that exist. While the report did not show the Farm Credit System to be insolvent, it certainly demonstrated a dramatic decline in the system's portfolio. The system showed a year-to-date loss at September 30 to be $426 million. The fourth quarter results are expected to show an even greater loss.

Congress has a vital role to play in finding a solution to the financially stressed Farm Credit System. We must assure borrowers and investors that the Farm Credit System will continue to be a viable provider of farm credit.

I was concerned that the third quarter financial statement indicated that the net loans as an amount of loans lent to farmers declined by 8.2 percent from the first of the year through September 30. This indicates to me that farmers are finding other lenders who are more competitive, or that they have simply lost confidence in the Farm Credit System.

I am convinced that the regulatory changes that have been proposed and discussed and which we'll hear more about today are necessary if the Farm Credit System is to continue in its function and prevent recurrence of its present problems.

Business practices have changed since the system was created in the 1930's. The system must reflect and utilize these changes. For example, the public now demands of public utilities and lending institutions that they be governed by generally accepted accounting practices and procedures in financial reporting.

While the Farm Credit System is unique in its agricultural credit mission, it must adopt acceptable generally acceptable accounting principles and be subject to a strong independent regulation.

I believe that the problems of the system should be attacked from several directions. The first approach involves the regulatory changes that I just mentioned.

The second approach involves the financial strengthening of the system. For the past few months there have been discussions and disagreements, or at least lack of agreements, over the form and magnitude of that financial assistance.

Hopefully, Mr. Chairman, these hearings that you have called will help us focus on the amount of financial assistance that might be necessary to stabilize and revitalize the system.

In our previous hearings on this issue I have expressed my personal concern about sharing jurisdiction of this issue with other committees; for example, the House Banking Committee, which has already conducted several rounds of hearings on farm credit. I believe that the Agriculture Committee should and can take the lead on this particular issue.

I am looking forward to hearing from our witnesses today to help us determine what the best information available is in helping us make a most responsible legislative decision on this very critical matter.

Mr. JONES of Tennessee. Thank you very much, Tom, for a very good statement.

Now I will yield to any other member of the subcommittee on the Democratic side for any statement they might want to make.

Mr. Glickman.

OPENING STATEMENT OF HON. DAN GLICKMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF KANSAS

Mr. GLICKMAN. Mr. Chairman, I would just echo what Mr. Coleman said. But I would just like to ask some questions in a statement and hope that the witnesses from the banks, from the Farm Credit Administration, and from the Reagan administration would be able to answer some of these questions.

I have kind of put together a list of questions that constituents have asked me.

To the farm credit banks, just how severe is the problem? Why is it that only now in the midst of a crisis that the system is asking for Federal financial assistance when just a few years back it was asking for additional authorities from this Government to compete with the private sector? How many borrowers will stay in business and how many will be forced out of business because of this crisis? What do you need to solve the problems? What are you willing to forgo internally to solve the problems? Can the system survive without Federal funds?

To the Farm Credit Administration, these questions: Why did it take so long for the FCA to identify these problems in the system? Should you have requested greater regulatory powers from Congress before now? What can you do to ensure that as many borrowers as possible survive? Can the system be preserved without an injection of Federal funds within the next 3 months, the next 6 months, or the next year? Are there problems out there in the field that have not been discussed, perhaps totally improper lending practices which perhaps you did not pursue until right now?

And to the administration I would ask, should it be Federal policy to support a cooperative system of farm lenders? Do you want to see the Farm Credit System survive or not? Will this administration stand behind the Farm Credit System? Does it consider the debts of the system obligations the Federal Government should either guarantee or provide a line of credit for? Does it consider the obligations of the Farm Credit System Federal securities or private securities?

In the administration's view, how long can the system survive without an injection of funds? How long can we wait before that injection of funds are provided?

I think, Mr. Chairman, what we are trying to do in all of this is to provide confidence in the marketplace, hope that the system does not fail, and protection against falling land prices which will no doubt happen unless some sort of relief is granted. We know that we want the system to provide some of this effort internally, but I think that it is a shared belief that some Government assistance is going to be required as well.

Thank you very much, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Glickman.

Any other member on the Democratic side want to be heard? If not, anyone on the Republican side? Mr. Cooper Evans.

Mr. EVANS of Iowa. Mr. Chairman, I my have a statement to submit for the record.

Mr. JONES of Tennessee. Thank you, Mr. Evans. Steve Gunderson.

OPENING STATEMENT OF HON. STEVE GUNDERSON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WISCONSIN

Mr. GUNDERSON. Thank you, Mr. Chairman. I too would like to ask unanimous consent that a statement be submitted to the record, and then very briefly would like to suggest to our witnesses and all of us, as we consider further this whole issue, that we do so with really five basic guidelines in mind: No. 1, that we do what has to be done now. I don't think we're looking at this as an annual occurrence. Let's look at a one-time solution.

Second, I think that we need to recognize that whatever we do needs to be done by the end of this year.

Third, along that line, then, let's resist the temptation to get into a comprehensive solution to all rural credit problems that will guarantee, as my colleague from Missouri indicated, a jurisdictional dispute and probably guarantee that we will not get a solution this year.

Fourth, I think if the Government is going to stand by the Farm Credit System, then we need to give the Governor of the system or someone more authority to regulate the system like we do with the other financial institutions in this country.

Fifth, to the greatest extent possible, let us make sure that the proposals that we pursue not only assist the system but assist individual farmers as well.

With that, I yield back the balance of my time.

[The prepared statement of Mr. Gunderson follows:]

STEVE GUNDERSON
3D DISTRICT, WISCONSIN

MEMBER
AGRICULTURE COMMITTEE
EDUCATION AND LABOR
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OPENING STATEMENT OF THE HONORABLE STEVE GUNDERSON
SUBCOMMITTEE ON CONSERVATION, CREDIT, AND RURAL DEVELOPMENT

OCTOBER 30, 1985

Mr. Chairman and Subcommittee Colleagues,

As we begin to hear testimony from the Farm Credit Administration, USDA officials and farm organization leaders with their ideas on how to solve the problems within the Farm Credit System, I'd first like to thank the Chairman for allowing me the opportunity to include a few brief remarks at this point in the record.

Since our opening hearing on September 11, 1985, when more than 25 farm state Members of Congress expressed their concerns over the problems facing the Farm Credit System and its impact on their own district, the financial situation of the FCS has worsened. When the Members of Congress testified, we talked about several ways that the System could be recapitalized and reorganized in order to continue its service to farmers and be equipped to handle problems in the future.

It is my Hope that the testimony we hear today and tomorrow will be more concrete in nature than what we heard in September. This subcommittee needs to put a package together as quickly as possible because the farmer borrowers in the System need to know what is going to happen to their cooperative.

THE PROBLEM

In the first nine months of 1985 the Farm Credit System has lost $426 million, a figure that is likely to increase significantly at year end. In 1984 the System had earned $363 million, nearly an $800 million turn around from right now.

While minimal earnings were recorded in the first and second quarter, losses of $522 million were realized in the third quarter. Losses for the last three months of this fiscal year could be even more. The problem with these losses is that the farmer borrowers of the System have to foot the bill with higher interest rates.

It is also interesting to note that loans in nonaccrual status, those loans that are uncollectable, increased from $2 billion at June 30, 1985 to $3.5 billion only three months later.

The System is looking at loan losses of more than $3 billion and non performing assets of $10 billion. In September when the financial condition of the Farm Credit System was made public, there were several people who felt that the problem wasn't that serious and that it could be worked out internally. With nonperforming loans near $13 billion and a capital surplus of $3.6 billion it is evident that the System needs federal assistance along with some restructrization so that the current situation does not take place again.

THE SITUTATION IN THE UPPER MIDWEST

While the numbers are not out as to the condition of the 7th Farm Credit District which serves Michigan, Minnesota, North Dakota and my state of Wisconsin, I anticipate that the numbers for the district will be parallel to those of the System as a whole.

While the St. Paul district has not encountered the problems that Spokane and Omaha have, it hasn't been a picture of health either. At the end of June of this year, the 7th district's PCA's had $400 million in nonperforming loans of which $23 million was written off. The Federal Land Banks in the district had nonperforming loans in excess of $904 million and had $11.3 million in charge-offs.

At the present time when a district has significant losses and needs recapitalization, the burden has been placed on borrowers from around the country to fund the ailing district. When this happens interest rates to the farmers rise which makes it more difficult for the farmers to pay off their loan thus making the individual district weaker on the whole.

I would hope that when a proposal is put together to keep the Farm Credit System a viable lending institution, we would first keep in mind the people that will be impacted to the greatest extent -- the farmers that own the Farm Credit System.

There has been a lot of talk about reassuring the investors of Farm Credit bonds that the System will continue to be a good sound investment. This is all fine and good but the bottom line is that the investors will "take the hit" only after the net worth and earnings of the farmer borrowers is gone.

American agriculture is at the point where commodity prices are the lowest they have been since the 1930s. Farmers that were good, efficient, conservative businessmen in the past are finding out that even their farming operations are in jeopardy of being foreclosed on. If farmers are forced to bailout other parts of the country in the future, there is going to be more dissention in the FCS than there already is.

POSSIBLE SOLUTIONS

Restructuring bad loans, infusing capital in a central reserve, fixing the loan rates, setting lending limits, reducing the capital requirement, guaranteeing bonds by the government plus several other proposals have been offered as possible solutions to the problems the Farm Credit System faces.

As we move forth in putting together a proposal I think we need to keep five basic guidelines in mind:

1) Do what has to be done now. We don't produce legislation that will cause Congress to have to deal with the problem on an annual basis;

2) Legislation needs to be passed by the end of this year;

3) Resist the temptation to include all rural credit institutions. This is an unique, individual problem and needs to be considered by itself;

4) Give the government the necessary authority to regulate the System if it chooses to stand behind it; and

5) To the greatest extent possible, make sure that the proposal not only assists the System but individual farmers as well.

With these points in mind, I look forward to the testimony of our witnesses this week and look forward to working with them in the near future as we try to maintain a lending institution that has served the farmers of this country so well for many years. Again, thank you Mr. Chairman for allowing me to address the subcommittee.

Mr. JONES of Tennessee. Thank you very much, Steve.

Jim Jeffords, do you have a statement?

Mr. JEFFORDS. Mr. Chairman, I would like to make my statement part of the record and raise a couple of points.

Mr. JONES of Tennessee. Without objection.

OPENING STATEMENT OF HON. JAMES M. JEFFORDS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VERMONT

Mr. JEFFORDS. First of all, I come from an area that has one of the three "healthy," banks in the system. I know that those healthy banks would like to help, but also would not like to be destroyed in the process of bailing the others out. We are small districts and, as I said, willing to help, but have comparatively few resources.

I would also hope that, as we look toward a solution, we will look toward one that will be long-lasting rather than temporary. On that point, I certainly would agree with the gentleman from Wisconsin.

I think that it is critically important that when we ask for Federal help—and I think we will have to—it's done in a way that it provides us with a long-lasting solution and not just a temporary bailout. The basic problem is the health of the farm economy. If we don't cure those ills, we certainly aren't going to cure the ills of the banks.

[The prepared statement of Mr. Jeffords follows:]

PREPARED STATEMENT OF HON. JAMES M. JEFFORDS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VERMONT

Mr. Chairman, the gentleman from Tennessee has accurately described the severity of the agricultural credit problem. There are no easy solutions, and its effects are now being felt all across the country.

To illustrate the lingering impact of this farm debt problem, let me talk about the First Farm Credit District.

The First Farm Credit District provides credit and related services to farmers and fishermen in the six New England states plus New York and New Jersey. Over 15,000 individuals borrow from localized production credit and federal land bank associations. In my state alone, the local associations provide over 50 percent of the credit extended to the farm sector. Farmers own these associations, as well as the district bank. I am here to tell you that this cooperative structure has worked well in the Northwest. The district bank and their associations are some of the best managed in the System. Loan losses have been held to a minimum and interest rates have not increased appreciably.

I am not here, however, to tell you that we are the best in the Northeast—that if every agricultural lender operated as our Farm Credit Banks do that there would be no problems. The Northeast is obviously different because of the diversity in agriculture within the region. In addition, the pressure from urban centers buffers farmland values that might otherwise decline.

Things are not great, however. The dairy provisions of the Farm Bill that we successfully debated in this Chamber will help, but the problem lingers on. Those 15,000 or more Northeast farmers and their cooperatives who are owner-members of this First District Farm Credit System have already been called upon to help their brethren in other Farm Credit Districts. Thus far, the Springfield District Banks have contributed $2 million in loss sharing funds and another $10 million to purchase non-performing assets of the Omaha and Spokane Districts. This is Northeast farmer money, and it results in somewhat higher interest rates for those farmers who borrow from the First District Banks. This interest cost is in addition to the now evident increase in the interest rates of Farm Credit securities being sold on Wall Street. Again, this is an added financial burden on an already financially burdened farmer.

Mr. Speaker, in the Northeast we do not fool ourselves that the modest size of our Farm Credit institution can save the large banks of the Midwest. Making healthy districts unhealthy and raising interest rates to all farmers is not the answer.

Like my colleague, Mr. Jones, we all must work together to solve this very complex problem. I pledge my support to work with him as well as others in the coming weeks to develop a solution that helps restore long-term profitability to the agricultural sector.

Mr. Jones of Tennessee. Thank you very much, Mr. Jeffords.

Now, if there are no other statements, the Chair will entertain the first witness, the Governor of the Farm Credit Administration, the Honorable Donald Wilkinson.

Don, without a doubt, you have some people with you that you would like to have accompany you to the witness table, and you may do so.

We appreciate very much your indulgence today. I am positive that each member of this subcommittee is looking forward with a great amount of anticipation to your statement. So you may proceed.

STATEMENT OF DONALD E. WILKINSON, GOVERNOR, FARM CREDIT ADMINISTRATION, ACCOMPANIED BY MARVIN DUNCAN, SENIOR DEPUTY GOVERNOR; LARRY W. EDWARDS, CHIEF EXAMINER AND DEPUTY GOVERNOR FOR SUPERVISION; AND FREDERICK MEDERO, GENERAL COUNSEL

Mr. Wilkinson. Thank you very much, Mr. Chairman and members of the subcommittee. I am Donald E. Wilkinson, Governor of the Farm Credit Administration. On my right is our Senior Deputy Governor, Marvin Duncan. On my left is our Chief Examiner and Deputy Governor for Supervision, Larry Edwards. And to the left of him is our General Counsel, Fred Medero.

We have prepared a rather comprehensive statement which we would like to submit to you, Mr. Chairman and members of the subcommittee, and respectfully ask that it be submitted for the record.

Mr. Jones of Tennessee. Without objection, so ordered.

Mr. Wilkinson. I will do what you have urged, and that is to condense it as succinctly as possible.

Mr. JONES of Tennessee. Let me say this. The Chair will make somewhat of an exception in your case as far as the minutes are concerned. I hope you will not have to go further, but if necessary, you may do so.

Mr. WILKINSON. Thank you. I will attempt to honor that, Mr. Chairman.

I would like to emphasize first something that I heard in the comments of those who have spoken. That is that the financial condition of the private farmer-owned Farm Credit System is critical but it is not at this time insolvent. However, changes are necessary to ensure that it can continue to fulfill its statutory mission and to minimize the possibility of a recurrence of this situation.

There are three areas in which I as Governor and we of the regulatory agency believe that action is necessary. First is the expansion of the Farm Credit Administration's enforcement powers and the clear definition of its role as an arm's-length, independent Federal financial regulatory agency. Second, the mandate that the system itself engage in self-help by pooling and managing its resources and distressed credit. Third, determine an appropriate level of public sector support for the system based upon the public policy objectives that it serves.

In our statement we have carefully documented the stress facing most of American agriculture, so I will not review that.

I would say, however, that this present economic environment stretches the financial resources of the major lender of agricultural credit to the limit. Any prospects for near-term improvement or even cessation of the unrelenting economic decline in agriculture have disappeared.

I would like to, out of that entire part of the economic review, stress and emphasize one particular point that addresses some of the questions already raised: What has happened so rapidly? Why now do we come to you?

Between 1981 and 1985, U.S. farm real estate values declined about $151 billion, with over $100 billion of that drop occurring in the past year. This erosion of real estate values greatly reduces the ability of lenders to collateralize loans to cover cash-flow shortages. And you members know the impact that has on the borrowers who are attempting to remain whole in their agricultural credit situation.

It explains perhaps more than any other factor why farm borrowers and farm lenders today now face their most serious crisis since the Great Depression. The problem focuses on the system because, unlike commercial banks, the largest share of its loan value is in real estate mortgages.

The effect of this on the Farm Credit System in general and on the Federal land bank portion of that system is profound. The U.S. Department of Agriculture in recent figures showed that about $4 billion of the Federal land bank debt is held by operators with debt-to-asset ratios between 70 and 100 percent and negative cashflows, and $3.5 billion is owed by insolvent operators.

This is only the Federal land bank's portion of the real estate situation. If land values should fall another 20 percent from January 1985 levels within the next 2 to 3 years, the Farm Credit Administration estimates that a cumulative total of $13 billion of system loans may become nonaccrual by the end of 1987.

Given past collateral recovery rates and future economic forecasts as a basis for loss projections, the restructuring and the liquidation of $13 billion of loans could result in chargeoffs of $6 billion by yearend 1987. $3 billion of that is now identified by the banks of the Farm Credit System.

Potential losses of this magnitude threaten the financial viability of the entire system. This is why contingency plans for financial assistance must be put in place at this time.

As we look ahead, based upon our own agency's analysis of the current and the projected financial condition of the system, parts of it are already nonviable. The system's competitive position may be lost well before the damage is reflected in its balance sheets, its financial reports.

This is true because any amount of capital is adequate only so long as investors in farm credit securities think it is. Adverse trends in financial ratios are likely to result from continued deterioration in the agricultural economy, additional loan losses, and loss of the system's ability to attract and retain financially sound borrowers.

These trends threaten the system's ability to continue to sell securities well before its capital is lost. The system would likely be unable to fund itself and yet retain substantial financial resources if the financial markets lose confidence in the ability of the system to manage its financial problems and become unwilling to refinance its maturing debt obligations. The effect then of a loss of market confidence would be devastating.

Solving the problem is why we are here today. In my opening comment I indicated there are three actions which we of the agency recommend to the Congress which we believe must be taken to solve this problem.

The first of these is one I now direct attention to, and that is: Truly establish the role of the Farm Credit Administration as an arm's-length regulator. To do this we have three proposals. One is, enable us to improve the checks and balances which we the regulator have on the banks of the system and the hundreds of associations in that system. This would require FCA to reassume direct responsibility for examining and supervising all system institutions. We believe that is the proper role of a financial regulator. Recent experience raises serious questions regarding the reliability of bank credit reviews in a stressful environment.

Second is the need for intermediate enforcement authorities. We recommend in this area the enactment of legislation establishing intermediate authorities for FCA comparable to those possessed by other Federal financial regulatory agencies. These authorities will permit FCA to stop or alter a course of action that the regulator believes is unsafe, unsound, threatens the strength and stability of a financial institution, or violates the laws, the rules, or regulations.

Specifically, we request that FCA be granted authority to issue cease-and-desist orders and temporary cease-and-desist orders, remove or suspend officers, directors, or other persons participating in the affairs of institutions, and impose civil money penalties.

These authorities would be exercised by the agency pursuant to statutory provisions requiring that a notice and an opportunity for a hearing be provided to the affected parties. If an order is issued, the affected party could also exercise the right to judicial review.

Third, we would recommend the increase of market discipline and accountability upon the private Farm Credit System. The stockholders, the owners of that system, the investors who make funds possible, have a right to accurate and timely information regarding the performance and the condition of system institutions. Through appropriate disclosure and clear lines of accountability, the market and shareholders can effectively discipline system institutions.

FCA has proposed regulations that would require banks and associations of the system to issue annual reports and information statements to stockholders. The entire issue we speak of here is full disclosure to the owners and investors.

We would also recommend here that a number of amendments presently in the statutes be deleted: Those which are not consistent with the agency's role as a financial institution regulatory agency, those which are more appropriately handled by the individual system institutions themselves, part of their management process. These amendments would specify that when FCA is required by statute to approve transactions, such approvals can be given through regulations not mandated in the statute.

This, then, is a summary of three major areas that would enhance the ability of the Farm Credit Administration to do its job.

Let me now go to what we would expect the Farm Credit System to be authorized to do in solving its problem. I have already indicated that losses in the system are growing at a rapid rate and threaten to overwhelm its substantial reserves and its ability to deal with its problems.

We propose that a Farm Credit System Capital Corporation be granted statutory authorities to implement system self-help efforts. Capitalized by the system's funds and staffed by highly competent workout specialists, the Capital Corporation's job will be to work out trouble system loans in a businesslike manner. This approach will allow the attention of the banks and the associations to then return to the business of making sound credit available to American agriculture.

There are four key aspects in this proposal. One, it mandates that the system pool its capital base; two, it permits the system to pool its distressed loan assets; three, it facilitates the restructed and disposal in an orderly manner, of its distressed assets; and four, it permits effective management of the system's own capital and Federal assistance.

These authorities could be carried out under the supervision and control of the Farm Credit Administration through its regulation and examining process. Within these parameters, we truly believe the system can better manage its own problems, but FCA would have the authority to intervene to protect the public interest.

Finally, let's look at our version of the public sector's support to the Farm Credit System. The decision of how much Federal financial assistance to provide to this Farm Credit System is one that truly can only be made by Members of Congress and by the administration, based upon the public policy objectives it wishes the system to serve.

FCA's responsibility is to recommend what it believes to be the most prudent course of action to preserve the essential elements of this Farm Credit System as a stable and reliable source of competitively priced credit to creditworthy farmers, ranchers, and their agricultural cooperatives.

We, therefore, wish to outline for your consideration three alternatives for public sector support. Now, we assume in all three of these that Congress will act to grant FCA its enforcement authorities as I have discussed, and clarify its role as an arm's-length regulator; and, two, that Congress will mandate that the system make the maximum use of its own resources by augmenting the role and authorities of that Capital Corporation.

Alternative 1: No financial assistance. This approach at best will increase system funding costs as investors demand an even higher risk premium on its securities for there would be no assurance that the Government would stand behind the system securities. This approach at its worst will cause the liquidation of the Farm Credit System.

From a borrower's standpoint, it increases the uncertainty of credit availability, it raises the prospect of loss of borrower investment of these stock issue, it increases upward pressure on interest rates and the downward pressures on land values. It also places tremendous pressure on the system's institutions to liquidate and dispose of its assets to generate cash to cover its maturing obligations.

That was alternative 1.

Alternative 2: A backup line of credit. This alternative is designed to provide the Farm Credit System with a backup line of credit from the Federal Government that can be drawn up to $5 billion. We recommend the use of a modified existing Governor's revolving fund, once the system's resources have been adequately committed.

This approach will negate many of the undesirable effects of that first alternative I reviewed. We believe this kind of a backstop would provide the necessary reassurance to the financial markets to ensure the continued availability of funds. This approach also keeps a desirable level of pressure on the system itself to establish greater efficiencies, greater creativity in serving the farmers and cooperatives, and to maximize the use of its own resources in dealing with problems without pushing individual institutions into a crisis management position.

This alternative should also stabilize interest rates on a system basis and reduce them for some institutions. It should alleviate borrower concerns over the loss of credit sources and encourage a more orderly process for managing those distressed borrower situations. Under this alternative, no tax dollar would be committed until a clear need to do so was evidenced.

Alternative 3: Upfront financial assistance. This alternative provides direct, upfront, financial assistance combined with the contingent line of credit. The Farm Credit Administration, as an independent agency of the Government, at this point is concerned with the immediate budgetary impact this approach would have. And frankly, we are also concerned that it would possibly reduce the system's incentive to increase its own operating efficiency and to creatively handle its stress management program.

In conclusion, we recommend the following congressional action for your consideration.

One, to grant the Farm Credit Administration expanded intermediate enforcement authority and to truly clarify its role as the arm's-length regulator of the Farm Credit System.

Two, mandate that the system use its own resources by establishing statutory authority for its own Farm Credit System capital corporation.

Three, establish an adequate backup line of credit to be drawn upon as the need is demonstrated.

Thank you, Mr. Chairman. We stand ready to attempt to respond to questions, please.

[The prepared statement of Mr. Wilkinson appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Governor.

I do appreciate very much your not taking any more time than you have thus far, thereby giving the subcommittee some time to question you and the group that is with you.

Now I yield to Mr. Coleman for any questions that he might have.

By the way, the subcommittee is on the 5-minute rule.

Mr. COLEMAN. I think all of us recognize that the Farm Credit Administration has some serious problems. I don't want to get personal, but I think that some of your credibility has been impaired. It was almost 1 year ago today that you and I had a conversation about this very subject in my office, in which I suggested that perhaps you were underestimating the seriousness of the farm credit crisis and that something ought to be begun to anticipate the very things that we are now being asked to do.

At that time, you felt that your estimation of the crisis was that you could handle it, you didn't need any other assistance, and that was about the end result.

As late as August 1 of this year, in a press release issued over your name, in Manhattan, KS, you said the following: "The Farm Credit System has the financial and human resources to handle its own problems without Federal assistance and makes proper use of those resources," according to you.

Of allegations that the system is on the verge of collapse and needs an immediate infusion of Government capital, you said, "It isn't, and it doesn't."

One month later, in an interview with the Wall Street Journal on September 4, you said that, "Farmers' troubles have outflanked the system's worst-case projections and left it floundering in billions of dollars of loans that are either uncollectible, or will be, within months. We have come to realize that the deterioration in agriculture has grown beyond the ability of the Farm Credit System to handle it," Mr. Wilkinson said, "We cannot absorb the losses we face."

In my experience in dealing with your organization, you all have been very sensitive to the concerns of the people who buy your bonds on Wall Street. Even the suggestion that there were problems in the Farm Credit System seemed to have been dealt with with the concern that interest rates or the premiums that you charge on your bonds, which eventually are paid by farmers—I understand that—would be increased. But perhaps that overly cautious attitude, or perhaps paranoid sensitivity to the market in Wall Street, has led you into the breach that you are faced with today.

So, I wonder how we can square all these statements that you have made and how your credibility now is being put on the line in asking us to accept in full faith the statements that you are making today.

Now, you have mentioned that you are asking us to provide changes in the law that, on page 12, you said, "correct unsafe and unsound banking practices."

Are you saying that there are unsafe and unsound banking practices being performed today in the system?

Mr. WILKINSON. May I respond to that specific question? We believe that the answer is "Yes" to that because of the inability at this particular time for all of the institutions, particular institutions of the system, to be able to strengthen its credit administration program.

This is an effort that must be accomplished if we are to prevent having to come back to you in 1 or 2 years. And we believe that the banks in the system truly have a desire to prevent those unsafe and unsound practices from continuing for credit administration.

Mr. COLEMAN. As the Governor—and I guess the buck stops at your desk in this organization—why didn't you do something about unsafe and unsound banking practices?

Mr. WILKINSON. Mr. Coleman, I did not mention it in my testimony, but as far as the authorities, the intermediate authorities granted to the Farm Credit Administration, we came to the Congress last February with a submission of a proposal. At that time, we were also, and still are saying, as you have evidenced, that the system still had the resources to adequately handle its problems.

That was based on several things. One is that the system's foundation, as I have already indicated, was its land bank program. We were witnessing some decline in land values, but we did not know that during this past year we would see over $100 billion of loss take place in the value of land in this country. That was the beginning of the undermining of the land bank part of the Farm Credit System.

A second point that I would like to emphasize is that back in the press release of September, when we began to recognize that there was a problem, we did not say that it was an immediate problem. I said that within 18 to 24 months the Farm Credit System would need assistance. And it is that desire that brings us here today so that the system will not face demise before there is a program that is in position to give it assistance.

I think there is one other point, Mr. Coleman, that is extremely important. And that is that the borrowers of the Farm Credit System within the last 1 or 2 years have truly been the ones that have at first absorbed the basic problems of a distressed agricultural environment, and now the lenders—not only the Farm Credit System, but the commercial banks—are facing that problem.

It was for these reasons then—declining land values; increased production, as mentioned in the USDA reports; loss of foreign market—that caused me and, in turn, the Federal board to change its position at the September meeting, Mr. Coleman.

Mr. **Coleman**. Mr. Chairman, I see that my time has expired, and I assume that because of the important status of this witness, that after others have a chance, that we might go around and ask questions?

Mr. **Jones** of Tennessee. Without objection. Thank you, Tom.

Now I yield to Mr. Weaver for 5 minutes.

Mr. **Weaver**. Thank you, Mr. Chairman.

Governor, I have been watching the financial situation of this country for many years and have been predicting its collapse for many years. But now that it's happening, I am getting some real serious whim-whams in the stomach.

My judgment is that the Farm Credit System is not just a mismanaged bank. We've had banks collapse in the past and they've created a ripple, but the system itself was intact. Today, I sense that while you may have done some things wrong, it's basically the fundamental system itself, the underlying basis for your system that's collapsing. Is that not correct? The land values, the farm income?

Mr. **Wilkinson**. Mr. Weaver, I think you have zeroed in on the basic problem. It's the underlying economic problems of the sector which this system serves that are causing the system's own problems today, to a very large degree.

Mr. **Weaver**. Well, I think that it is not limited to the farm sector. My timber and lumber sectors are in the same trouble. As a matter of fact, in the financial situation I see a whole fleet of *Titanics* out there, and we are all on the bow of the ship looking at icebergs.

May I ask you this, If the Congress or the administration bails out the Farm Credit System with a line of credit—and that's what it is, Governor, let's face it; that's just Federal money—we've got $360 billion of Latin loans out there to our big banks. They're going to ask to be bailed out. We've got $300 to $500 billion in savings and loans and thrifts, and they're becoming shaky as the real estate market falls. And it's going to continue to fall. Farm values are only the first.

We've got $2 trillion of personal debt, $2 trillion of business debt, and $2 trillion of U.S. Treasury debt. If we start by bailing out the Farm Credit System, where does it stop? That's my question.

Mr. **Wilkinson**. Mr. Weaver, I think that our concern has already started in other areas of the financial arena that you have addressed. I think the basic question is, What does a major sector of this economy; namely, agriculture, its farmers, its ranchers, need as compared to some of the other areas that you have addressed, the foreign nations of the world?

I think that in its due wisdom, it is our hope that the Congress would recognize that the basic sector of America's economy starts with the American farmer in food and fiber——

Mr. **Weaver**. By the way, Governor, I couldn't agree with you more.

Mr. **Wilkinson**. Yes, sir.

Mr. **Weaver**. Farming is the foundation of the rest of our economy, and Americans had better know that.

Mr. **Wilkinson**. Second, Mr. Weaver, I would like to emphasize to you that I do not consider this a bailout without an effort, a true effort, on the part of this Farm Credit System to repay its Government investment. It has that reputation. It did that in a very noble, professional way in its early capitalization by the Government. Anything that we have addressed here this morning would be addressed in a term of a line of credit with repayment expectation.

I would hope that the other areas that you have addressed would be cast in the same light, sir.

Mr. **Weaver**. Governor, I understand, and that is a very sympathetic position you take. But you ask for $5 billion now, as you have done. You're going to ask for another $5 billion and another $5 billion, and the rest of the financial institutions are going to come in and ask for their $5 billion, and they're going to go on and ask for it.

Mr. Chairman, I really believe that the questions that this subcommittee has to ask should be addressed to Treasury Secretary Jim Baker. I think Governor Wilkinson rightly can respond to the farm sector, but we need to ask the overlying question. I can't vote—I cannot possibly vote—to bail out the Farm Credit System without knowing what is going to happen to the rest of our financial institutions.

I would hope that Treasury Secretary Baker could be asked to come to this subcommittee. With that, Mr. Chairman, I yield back the balance of my time.

I thank the Governor.

Mr. **Jones** of Tennessee. Thank you, Mr. Weaver.

Mr. Jeffords.

Mr. **Jeffords**. I have two questions, and I hope we can fit them in 5 minutes. I will try to be brief.

At present, we have 12 districts, 6 of which are in trouble, 3 that are staggering, and 3 that are healthy. The three healthy ones—Texas, Baltimore, and Springfield—only have about 14 percent of the outstanding assets of the system. I am concerned by your statement that, "We're going to maximize self-help within the system."

My question is, What kind of an impact do you feel your proposal will have on those healthy banks?

To quote a member of our bank, "You can't save a bleeding 1,400-pound steer with a blood transfusion from a 200-pound calf." [Laughter.]

I would also like to know, if we get into changing the language which gives you authority to reorder the system, what you have in mind and what the implications would be on the three healthy systems?

Mr. **Wilkinson**. I think the first recognition that must be identified, Mr. Jeffords, is that while we have 37 banks of the Farm Credit System, they are truly tied together in two manners. One is that they have long had a business agreement and, in a statutory requirement, that they will stand together to share losses. They go to the market, second, as one institution, the Farm Credit System and its consolidated bonds and discount notes, and they place all of the collateral of the banks and the associations behind those bonds.

Now, the concern you express is a very justifiable concern because in the districts you have referenced, and in many other associations across the Farm Credit System, they have truly acted in a sound and prudent manner in trying to effectively serve while protecting their resources. And yet, they must recognize that they are one. They are locked together. They are tied together. They are severally and jointly liable as they go to the market.

They have agreed to date, in addition to the points I have mentioned, to go together in a financial assistance program to assist the two districts that are securing assistance and that every one of the districts has participated in that program.

This proposal of ours, two, is one which would establish a Capital Corporation which would establish the parameters by which the funds could be available, the resources available from all parts of the system to be utilized wherever necessary before there would be Federal financial assistance available as per our recommendation, Mr. Jeffords.

Mr. JEFFORDS. Well, I would tend to disagree with the strictness with which you say there is a relationship at present under the law. It seems to me you're asking for that authority.

My second question is, You are asking to set up a new entity, a farm credit capital corporation. You mention the revolving funds, which are already in existence, although the funding authority for them is minimal and only one of them has any significant funding at all.

Why do you need a new entity? Could you not accomplish your purpose by funding, with perhaps a Government guarantee, the revolving fund? Is it necessary, really, at this point to do much else?

Mr. WILKINSON. One, Mr. Jeffords, the Capital Corporation of the Farm Credit System is already in existence. It is a duly incorporated entity of the system.

Two, we have the conviction that the system should attempt to do everything it possibly can as a private financial institution, utilizing its resources. And that would include its own Capital Corporation.

Three, the revolving fund of the Governor was never designed for that purpose. It essentially provides funds for capital infusion. And it is a very minimal fund, as you mentioned, some $225 million.

Mr. JEFFORDS. I think you have $260 million in the cooperative and PCA funds and none in the land bank fund. I think that there is authorization for only about $6 million in the land bank fund.

Mr. WILKINSON. Summarizing my answer to your excellent question, we would say that we do not believe that this is totally a proper role for a Government regulatory to be involved in this manner. Instead, we would urge the private structure to make full use of its resources through its own vehicles. But you would have granted statutory authority beyond that which it now has as a private corporation.

Mr. JEFFORDS. I see my time has expired.

Mr. JONES of Tennessee. Thank you very much, Mr. Jeffords.

Now I yield to Mr. Glickman for 5 minutes.

Mr. GLICKMAN. Thank you.

First of all, Mr. Wilkinson, I want to compliment you on hiring Mr. Marvin Duncan as your chief deputy governor. I have worked with him at the Federal Reserve System in Kansas City. He is an outstanding public servant, and I hope that you will rely on him for advice in this area.

Mr. Wilkinson, one of the interesting things in your prepared statement—and this doesn't really relate to the Farm Credit System—but on page 13 you say, "The FCA proposes to eliminate the statutory provisions authorizing and directing FCA to delegate its duties and powers to the institutions of the system."

What you are saying there, basically, is that deregulation of financial institutions does not work. And the Farm Credit System in this country has been an example of an entity which has deregulated the enforcement powers to the people who are operating the system.

In the 1930's we found that that didn't work for the banking system, and we created a whole system of FDIC, the Comptroller, to protect the public against the fox watching the chicken coop.

I would say what you are doing here, which I support, ought to be an example to a lot of people in this country, policymakers on high in Washington, that when it comes to protecting the public interest, sometimes deregulation is not the best way to go, particularly in financial institutions.

It may have been, over the last few years, as Mr. Coleman suggested, that you didn't do enough internally to regulate the system. But I submit that probably more than anything else, we were operating within a statutory environment of deregulation, and it just doesn't work when you regulate banks and financial institutions. And you are basically asking for the same powers that the FDIC and the Comptroller have.

Mr. WILKINSON. Yes.

Mr. GLICKMAN. And I think by doing that, you make the acknowledgment that deregulation hasn't worked in your case and we need to move to a more stringent regulatory environment. Am I correct?

Mr. WILKINSON. That is correct as far as that entity that we are familiar with.

Mr. GLICKMAN. Well, I would suggest that the people in the banking system in this country and other financial institutions take heed from what you are doing here, because what we have seen in agriculture is a depression along the lines of what we had in the 1930's which caused the banks to be regulated under a more severe regulatory scheme, and I don't want to see us turn back into a situation where the rest of the country has to go through what agriculture did.

Second of all, I would say, basically what you are saying is if we do nothing, land values will fall. If land values fall precipitously, it not only may actually bankrupt the Farm Credit System, it could bankrupt all of the agricultural banking system in this country and lead to much more chaos than currently exists. Is that a fair statement?

Mr. WILKINSON. That is a fair statement, Mr. Glickman. And I would direct your attention to pages 8 and 9 of the prepared statement because we have reflected the adversity facing the commercial banking industry.

Mr. GLICKMAN. OK. Now, in doing so, you propose three solutions. One is, greater regulatory authority, which I support. Another is a mandatory pooling so that we take advantage of the situation that maybe Mr. Jeffords' bank doesn't want to participate and maybe some of the other banks don't have the financial resources to engage in a voluntary participation. And that's the clear recognition, that second solution, that you're one system, you're not 12 or 13 separate systems.

Mr. WILKINSON. Right.

Mr. GLICKMAN. And a lot of people aren't going to like that who like the decentralization of the system, but you probably aren't able to solve the problems without doing that.

The third thing you propose is a $5 billion revolving fund. That's your upfront Federal dollars. Now, assuming that we can find the money, even for a revolving fund, in this era of Gramm-Rudman and other constraints, financial restraints, you state in your prepared statement that under this alternative, "No taxpayers' funds would be committed until the clear need to do so was evident."

I ask you, one, When will the need be evident? And how much will you need? And do you have administration support for that $5 billion revolving fund?

Mr. WILKINSON. One, Mr. Glickman, you use the term "upfront." We were not thinking in terms of having $5 billion immediately available. I think you understand that.

Mr. GLICKMAN. That's right.

Mr. WILKINSON. It is a line of credit. It would only be tapped if and when the need is there.

Mr. GLICKMAN. Do you foresee the need being there?

Mr. WILKINSON. If we had a better vision of what the economy is going to be in 1987 and 1988, then we would answer that question. But we have to anticipate that the need may be there because we can't come to you 2 years from now and ask for that.

Mr. GLICKMAN. All right. And how much do you think of that you're going to need in the near term, assuming that there is no difference in the farm economy?

Mr. WILKINSON. Would you permit me to permit the individual that you addressed earlier, Marvin Duncan, to answer that?

Mr. GLICKMAN. Sure.

Mr. WILKINSON. He has been working closely with various parties on that issue, Mr. Glickman.

Mr. GLICKMAN. OK. And also, I want to know if the administration supports this proposal.

Mr. WILKINSON. We will get to that; yes, sir.

Mr. DUNCAN. Mr. Congressman, we do believe that if there are no changes in the current economic forecasts for the agricultural sector, and if asset values in agriculture continue what has been in the last 2 or 3 years a precipitous decline, by anyone's measure, that the system will indeed reach a point somewhere within the next 1½ to 2 years or perhaps slightly less than that, in which it will have fully mobilized its own resources, earned equity within the system, and it will need to tap that Federal revolving line of credit.

That line of credit we envision to be tapped only as needed, only to the extent needed, and we would anticipate developing some rather stringent regulations with regard to when and at what time that fund could be tapped.

We would anticipate the system would repay whatever it borrowed under that line.

Mr. GLICKMAN. Mr. Chairman, would you mind if Mr. Wilkinson answers the question of does the administration support this $5 billion line of credit?

Mr. WILKINSON. I would like to answer that by indicating that at this time we have no indication from the administration evidencing their willingness to support that particular proposal.

We were hoping that perhaps the administration spokesman this morning, Mr. Naylor, may have some information. I have no further information.

Mr. GLICKMAN. Well, my time is up, Mr. Chairman. I would just say that I hope the administration is upfront with what they support.

But I hope Mr. Wilkinson, too, as you heard from Mr. Coleman, that you have the necessity to be very upfront about what your needs are, when you're going to use this money, how you're going to use this money, all the questions that there is some doubt here on this panel.

Thank you.

Mr. JONES of Tennessee. Thank you very much, Dan.

Now to Mr. Stenholm for 5 minutes of questioning.

Mr. STENHOLM. Thank you, Mr. Chairman.

I want to pursue my question along the lines of your request for additional regulatory authority, and I want to go back to 1977, in which at least one production credit association in Texas, and many times since then have continually asked Farm Credit, the Farm Credit Administration, for the ability to build up additional reserves for loan losses.

In testimony before this subcommittee 1 month ago, we had this documented, and it's now in the record, in which many folks out in the field have been asking for years the ability to build up reserves for such a day as we now face.

But the record is very clear that you and others have turned this consistently down, have consistently said, "No, you have to document it," even though the law very clearly provides for reserves over and above the 3.5 percent.

On May 17—or February 22, rather, Mr. Thomas, Mr. Tallon, and myself wrote you, as we also wrote at that time Secretary of the Treasury, Mr. Regan, the Comptroller of the Currency, Mr. Conover, Mr. Edgar, Commissioner of Internal Revenue Service, recognizing the difficulties and the reasoning and the logic of why you and others in farm credit have always been concerned about allowing Farm Credit Systems to build up reserves because of concerns from IRS, et cetera.

We wrote all of these entities. We received very few answers.

Mr. WILKINSON. Sorry.

Mr. STENHOLM. Very few answers to it.

But again, my question is, why—why has the Farm Credit System been concerned or nervous or so cautious about allowing the folks out in the field to build up reserves as institutions, as we have encouraged farmers to do—unfortunately, not as good a job in the last few years? But why has this been the case?

Mr. WILKINSON. Mr. Stenholm, may I ask our chief examiner to respond to that question?

Mr. STENHOLM. Yes, sir.

Mr. WILKINSON. Because he is personally very familiar with the Texas issue. Mr. Larry Edwards, please.

Mr. EDWARDS. As the subcommittee is probably aware, the PCA's have in the statute a specific reserve-for-loss requirement that allows them to build 3.5 percent of outstanding loan volume in reserves for losses, and that reserve for losses is a tax deductible expense for the institutions.

Congress granted that, recognizing that special nature of the system institutions indicated some need for them to build stronger reserves than multipurpose lending institutions might be allowed to have.

Over the years, that reserve requirement has been attacked a number of times by the IRS, and it has been the system's view and that of their tax counsels over the years that that reserve should not be pushed beyond the 3.5-percent limit at the risk of losing it.

In retrospect, that was probably not a very good decision, and in some PCA's the reserves for losses should have been built higher than 3.5 percent.

The agency has not encouraged that, but there has not been any restrictions from the agency on the extent to which associations could build their surplus accounts in the net worth section of their balance sheets, which could have been used to offset some loan losses.

We will be requiring associations to move to a GAP-based accounting for reserve for losses for financial reporting purposes in 1986. For some PCA's, for financial reporting purposes, that will mean a reserve that's less than 3.5 percent because GAP would not support that high a reserve. For others, it would mean a reserve for losses that does exceed the 3.5 percent.

Mr. STENHOLM. Mr. Chairman and members of the subcommittee, I hope you all caught the significance of that answer, and I think that goes back to Mr. Weaver's statement that there are others in Government that also need to be accountable for some of their past suggestions in the area of regulatory capacity.

I personally agree that there is going to need to be some additional regulatory authority vested in farm credit. That's going to cause a lot of consternation out in the country, I might add, and we are all aware of that. But if, in fact, we are going to have the taxpayer involved in any level whatsoever in this, then certainly you are going to have additional regulatory authority.

But the point of my question is that there have been decisions made in the name of regulatory authority that have contributed to the fact that our reserves in the Farm Credit System today are not sufficient to meet the needs.

If those in the regulatory-making departments—in this case, IRS and Treasury—would have recognized, too, the direction in which farm credit and the problems of agriculture were heading, we could have had some additional reserves within the system. But we have been stifled.

And I, Mr. Wilkinson, do not hold you totally without fault, in the belief that we should have pushed harder, because at least three members of this subcommittee in February 1984 suggested at that time we should have gone forward. You did not do so to the degree that I felt was necessary, or that Mr. Thomas and Mr. Tallon felt.

But that's hindsight, and we can't worry about that. But certainly, I think we need to recognize the importance of all of the agencies involved of getting in the same boat and rowing together.

Thank you.

Mr. JONES of Tennessee. Thank you very much, Mr. Stenholm. Now to Mr. Gunderson for 5 minutes of questioning the witness.

Mr. GUNDERSON. Thank you, Mr. Chairman.

Let me begin by saying if I had asked Mr. Glickman's questions myself I couldn't have done a better job in the line of thinking that I was intending to do, and I just echo most of what he said.

I think that if there is a criticism that exists here today with the Farm Credit Administration, it can only be a criticism that you did not have the gall to come to us earlier and ask for authority that at that time we most likely would have rejected anyway. But that's the only criticism I can portend for you.

I think it most interesting, as I look back on the last year in my own congressional district, those in the St. Paul district are well aware of the criticism they received and I received and everyone else received because some local districts' production credit association, particularly in River Falls, WI, had the gall to get tough. They had farmer demonstrations and they had appeals to their congressional delegation and everyone else to step in and make sure that that particular production credit association land bank did not make the kind of decisions that they were making.

I think it's reflective, however, of the difficulty you have in any cooperative, and I am not criticizing cooperatives, but when farmers are asked to regulate farmers, there becomes an inherent tendency to fight that, and certainly a public pressure among that constituency to challenge it in the other end, which clearly means to me that our problem is that we have not given the Farm Credit Administration the authority that you should have had.

So I guess there is a criticism of this Congress for not doing it, and as I said, if there is any criticism for you, it would only be that you didn't have the gall to come and ask for that sooner.

If there is any doubt, I would like to clearly indicate that I recall your warnings to this very subcommittee last winter when we were dealing with the farm credit crisis that what was going to happen in farm credit this year if the deterioration continued, and I certainly found nothing that's surprising when these revelations began occurring.

And when finally the system decided to come forth, frankly, I compliment you and appreciate the honesty which you gave us within the bounds of your concern over creating undue hysteria and challenges to the market integrity at that time.

I would like you or any of your associates to respond to, by comparing or contrasting the authority of the Farm Credit Administration with that of the other financial regulatory agencies in existence today. Could one of you enlighten us in that regard?

Mr. **Wilkinson**. Yes; thank you, Mr. Gunderson.

I think our general counsel is in an excellent position because he has served under the Comptroller of the Currency. He has worked with all of the financial institutions.

Mr. Fred Medero, please.

Mr. **Medero**. Mr. Gunderson, the other banking regulators have the kinds of powers that we have put forth in our testimony today as requesting, which we call intermediate enforcement powers.

The basic difference between the Farm Credit Administration's current powers and those of the other banking regulators are that the other banking regulators can deal with specific problems with specific tools—specific legal tools, specific legislative tools; that is, the cease-and-desist authority, the removal of officers and directors, and the imposition of civil money penalties—to address themselves at specific problems that are uncovered in the examination process.

FCA, unfortunately, is relegated to using what we call its approval authorities, which are numerous throughout the statute and there are some which are significantly important and can be emphasized over others. The approval authorities are an inadequate means of regulating a financial institution, for two reasons. The first is that they frequently don't have anything to do with what the real problem is, and one becomes involved in issues which are really not the issues that are on the plate to be dealt with.

Two, it typically puts the regulatory agency into the business of becoming too involved in the actual management of the institution itself.

And three, the exercise of that approval authority typically does not solve the problem—in fact, sometimes creates an additional problem. To give you an example of that, the agency's most pandemic power is the power to approve bond issues, and a great deal of its authority emanates from that power. Unfortunately, it's a power that, when used, would probably cause more of a problem than the problem that it's attempting to solve.

So that is why we have come to the subcommittee requesting that we be given what we call intermediate enforcement powers so that we can leave the approval authorities to what we would call a veto approach, of being able to get information concerning the activities of the bank and be able to intervene in the event that we found an unsafe or unsound practice, and then having the authority to go in on specific instances based on our examination of the institution and bring specific remedies to bear on the problems that we might uncover so we might get those solved specifically without becoming involved in the management and interfering in the ongoing activities of the institution to the detriment of the business itself.

Mr. **Gunderson**. Thank you. Very quickly before my time expires, could you expand on the $5 billion which you believe is necessary? We have heard speculation of anywhere from $6 to $15 billion is needed in the system. Could you comment on that?

Mr. **Wilkinson**. I think I will ask Mr. Edwards, if I may, Mr. Gunderson, to respond because he has been working the numbers, the estimated losses. May I do so, please?

Mr. GUNDERSON. Surely.

Mr. WILKINSON. Larry.

Mr. EDWARDS. A definition of viability for the system is a very subjective kind of judgment, the point at which it crosses over the line and can no longer earn its way back to health, given a reasonably good operating environment.

Our projections would indicate that the system has potentially facing it about $6 billion in losses, given the outlook that we believe the economy presents. Roughly half of that is already identified by the banks. The $5 billion is the amount that we think would be required if the maximum amount of losses that we believe face the system are, in fact, incurred; $5 billion is what we think would take to bring it back to viability.

Mr. GUNDERSON. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Gunderson.

Now before I yield to Mr. Thomas for his 5 minutes, I want to—and I am sure you will not object—recognize the chairman of the full committee, Mr. de la Garza, who has been waiting patiently with us. He has many responsibilities, and I do want to thank him for being here with us today.

Mr. de la Garza, if you have anything you would like to say, now is a good time to say it.

The CHAIRMAN. Thank you very much, Mr. Chairman. I would not like to break the line of the members of the subcommittee. I just want to thank you for having this hearing of the members of Farm Credit System, Governor Wilkinson, and the other witnesses that will be here.

Beyond that, Mr. Chairman, I would defer to the members of the subcommittee.

Mr. JONES of Tennessee. Thank you very much, Mr. de la Garza. And I am sure that I express the sentiments of each member of this subcommittee in thanking you for your cooperation on this grave subject and for the cooperation that you have given this subcommittee.

Now I yield to Mr. Thomas 5 minutes for questioning.

Mr. THOMAS. Thank you, Mr. Chairman.

Governor Wilkinson, I feel sort of like the old proverbial person caught between a rock and a hard place here this morning in that I am an old friend of farm credit services, production credit associations. I like to tell that the first honorarium I ever received was five silver dollars when I was 12 years old speaking at the Sitilla Production Credit Association down in Pierce County.

I am now a client of both the production credit association and the Federal land bank, a borrower, a stockholder. I am happy to report that my loans are all up to par this morning. [Laughter.]

"As of this morning," one of my colleagues commented. [Laughter.]

But I think that what we're proposing here, I am certainly very concerned about the situation specifically of farm credit services. Unquestionably I am. And I know we have to look at that specifically, although I am very concerned about the entire farm credit situation pertaining to commercial banks and others.

But over the years the Federal land bank has been a unique institution. There has been considerable participation by farmers in it, serving on various boards, making judgments because they knew the people who were the clients of the various systems. And it seems to me that what we are doing here, let's be candid, is debarking almost totally from that type setup.

That concerns me greatly, and it does for two reasons. First of all, that farming is a unique business, and sometimes credit standards that are applied in certain other type loans and certain other industries just don't work with farming.

I remember when SBA came down in the late 1970's to Georgia, after that drought in the disaster year there with the drought in Georgia, and got into the lending business, that they as well found out in a hurry that farming was indeed a different business. And they will tell you that openly and candidly as well.

But this concerns me when we begin to take away and take out of the picture those local people who know the individual farmers and know the kind of mettle they're made of and who they are and what their background is, and all of a sudden apply the same standards here that we might to any other type loan.

I am very concerned about that. I would like for you to comment on it because it sounds to me as if we are going to change the authority and give farm credit councils, the FCA, the specific authority that we're going to do, and take it away from any of these board members who have served on the boards, who know farming in various areas.

I am very concerned because it seems to me that we're just going to change it into a lending institution like all others. And it would follow, to me, then, if a farmer who can borrow money elsewhere—and certainly we are realizing right now that in many instances he can borrow money cheaper than he can in this case—what is going to be the incentive for him to even stay involved in the farm credit picture any longer, with the Federal land bank or production credit associations? What will be the incentive?

Mr. WILKINSON. Mr. Thomas, you have, I think, very effectively articulated the strength of the Farm Credit System over its nearly 65 to 67 years in the land bank, 50 years in the PCA's. And the strength of it is the ownership by the farmers themselves, the involvement of those duly elected farmers to their respective association and district boards.

I am not interested, Mr. Thomas, in removing directors from the management of the Farm Credit System—from the policy end of the Farm Credit System. I want to correct that. And nothing that we have proposed here this morning would mandate that in any kind of a program which would make use of all of the financial resources. There is nothing that would remove the ability of duly elected association board members to advise the servicing of those loans, the service needed in those local communities at that association level.

Second, through that election mechanism, they would elect the directors that would be serving on the district boards as they now do, where there would be this capital that would be consolidated. And they, in turn, would have much to say regarding the operation of the Capital Corporation and how it administered its financial abilities.

Our thrust in the Farm Credit Administration is to still hold the stockholders, the farmers who own this system, accountable for its activities. That in no way needs to imply that there is any mismanagement or unsound, unsafe credit administration, for farmers themselves can be very good, shrewd businessmen, and I am not recommending the removal of the grassroots involvement, Mr. Thomas.

Mr. THOMAS. Well, I see that my time is rapidly running out. I have got the yellow light.

I would just say to you that as Members of the Congress, we just talked about the hard place. The rock on the other side is the fact that I go back to my district and talk to farmers who are the clients, the people who elect me and the people that I am very concerned about, and I have to be able in the end to say to them that whatever change we make here does not change this institution into something that it was not intended to be from the start and that it still is going to give us the chance to allow agriculture in its various unique areas where it has its own characteristics, for those considerations to be heard, and that we are not going to simply take the position that some have seemed to think is the only way out of this whole credit debacle, and that is simply to let the hide go with the hare. That kind of approach, I can't support.

Thank you, Governor.

Mr. WILKINSON. Thank you.

Mr. JONES of Tennessee. Thank you very much, Mr. Thomas.

Now I yield to Mr. Cooper Evans 5 minutes for questioning.

Mr. Evans.

Mr. EVANS of Iowa. Thank you, Mr. Chairman.

I would like to pursue the line of credit just a bit. I am pleased about that and support it as a concept. But I have some questions. Who would control access to that? Would it be you? Would it be the Secretary of the Treasury? Would it be the Capital Corporation? Who would have to make the approval for access to that revolving fund?

Mr. WILKINSON. Mr. Evans, I guess I would have to say to you, as you well know, this is still one of the negotiable items. We haven't heard from the administration. We have no idea how the Treasury might view this particular aspect.

But in our proposal, the concept there would be that the Capital Corporation would make full use of the resources as they work with the entire system. At a point where, as Mr. Edwards indicated, we would deem the system to be reaching a stage of insolvency, or just prior to it—and this could be done by some rather specific objective viability standards, Mr. Evans—then FCA, FCA would make a determination that the system had used its resources, was now in a position to trigger a line of credit from presumably either the revolving fund or, if the Treasury is involved, there may be some access there.

Mr. EVANS of Iowa. But you do see yourself as a regulator or the Governor of the FCA, as playing a role in when there is access to that fund?

Mr. WILKINSON. I definitely do, sir.

Mr. EVANS of Iowa. Yes; and the Treasury may reserve some rights in that?

Mr. WILKINSON. Well, sir, I may——

Mr. EVANS of Iowa. You don't know that.

Mr. WILKINSON [continuing.] Presume they may.

Mr. EVANS of Iowa. OK. What sort of interest rates would be charged by the Treasury against the Farm Credit System for that revolving fund?

Mr. WILKINSON. Mr. Evans, we have no indication at all of, one, would they charge interest rates, would they defer interest rates, what rates would they charge, because we have not heard from them.

Mr. EVANS of Iowa. You implied that these funds would be paid back and the record of that is excellent in the history of the Farm Credit System. And I believe that they would. Who would pay it back? I mean, would it be an assessment over the overall system? Would it come out of accumulated earnings of the entire system? How do you envision the payback would be handled?

Mr. WILKINSON. Again, it would be rather directly related to how the funds may be used. If the funds are used to purchase stock within the Capital Corporation, for example, which is one alternative, then we would presume that the Capital Corporation on behalf of the system would make repayment to the revolving fund.

Mr. EVANS of Iowa. OK. I would like to move to a different area, if I can. You know, we've talked a lot about the system this morning and what we're going to do to try to save the system. We haven't talked very much about what we're going to try to do to help farmers. And it's a very natural thing in view of our concern for the system.

But one of the concerns that I have has to do with the restructuring of debt, and you used that word in connection with the Capital Corporation as you went along. But it seems to me that it's terribly important that the system do more through its associations and banks to restructure debt before it is put in the highly questionable category and passed onto this Capital Corporation for, as you say, restructuring and disposal.

Now, that doesn't sound terribly constructive for farmers as far as I am concerned. I get the impression that once a loan is declared to be a basket case, it's moved over to the Capital Corporation to handle and concern for the farmer sort of rapidly disappears at that point.

I know that in the Midwest, restructuring seems to be a dirty word as far as debt within the Farm Credit System and trying to work things out with individual lenders. And I think that is a terrible mistake for agriculture.

Now, are we going to pursue the course we've been following and be very reluctant to restructure debt, or are we going to change that?

Mr. WILKINSON. There are two things I think we would want to stress in answer to your question. How can this benefit farmers? That is our only reason for existence. We're not trying to save a system for that sake, we're trying to provide a credit mechanism to serve those farmers.

The No. 1 thing that can help farmers is the alleviation to some degree of the interest rate. The No. 1 factor here is to provide to the investment community confidence that the Government will stand behind these farm credit securities.

Two, is that we truly believe that this Capital Corporation concept can enable the system either through the Capital Corporation with its team of experts on restructuring—not necessarily, Mr. Evans, liquidation of farmers or foreclosure—greater interest in restructuring the loans and also greater emphasis out at the lending institution itself in that area. That is the whole emphasis of trying to have this system work with its associations and its borrowers.

Mr. EVANS of Iowa. It isn't really clear to me how it would help one of my local farmers if he's told, "Well, your loan and the whole case is being transferred to the Capital Corporation in Denver or Omaha or wherever it may be, and they're going to try to work something out with you," and there is a complete severance of any local involvement or anything of this kind. I think that guy is done, and I think we need to review our approach to this.

Now, I know I am out of time, but I want to ask you one more short question or make a statement if I can. It seems to me that a lot of the problems of the system can be handled internally if the various institutions are given more time to absorb losses. You talked about $6 billion chargeoff possible by the end of 1987, if all things go bad. That would be a terrible blow for the system to handle.

But would you not agree with me that if the system had, say, 10 or 15 years to digest that loss, it would be much more manageable? And I don't hear anybody talking about permitting absorption of these losses over an extended period of time, and I am curious as to why that is.

Mr. WILKINSON. I think the thing you would have to recognize is that those losses have very immediate carrying costs. They're with you all the time. Someone is paying for those losses, and that someone, Mr. Evans, happens to be the sound farmer of the cooperative credit system. And that's the concern that I think the institutions as well as the regulator would have, would be trying to alleviate that debt load as rapidly as possible so that it's not an undue burden to the sound farmers who own the system.

Mr. EVANS of Iowa. I wouldn't disagree with that, but I think we need to explore that further.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Evans, for those questions.

Mr. Stallings, I believe you were next.

Mr. STALLINGS. Thank you, Mr. Chairman.

Governor Wilkinson, I would like to followup on Mr. Evans' question for just a moment.

As I understand, the Capital Corporation has already purchased nonperforming loans in the Spokane district. What is happening now to those loans?

Mr. WILKINSON. Mr. Stallings, Mr. Edwards has been working directly with that organization. May I refer the question to him, please?

Mr. STALLINGS. Please do.

Mr. EDWARDS. I don't think the fact that a loan has been transferred from a PCA or an FLBA to the Capital Corporation necessarily means that the status of that borrower is going to change at all. The Capital Corporation doesn't have any more authorities to deal with that than do the banks.

What it does do, though, is take the pressure off a local association that may be in severe financial stress and have no alternative but to institute rapid foreclosure and spread that risk out.

I think you can bring greater expertise to bear on that restructuring and probably improve upon the chances of restructuring.

The Capital Corporation's portfolio was purchased in Spokane. They are proceeding through that loan by loan. Some are restructured, some are being selected because that is simply the only business alternative available.

The objective for the lender is to work through that loan in a businesslike a basis as possible. If restructuring that loan means that's the best deal for the institution and the farmer together, that's the way it's done.

Mr. STALLINGS. Let me continue with the Spokane district. Over a year ago the Spokane FICB was on the brink of failing. In fact, eight production credit associations were liquidated before the Twelfth District Bank sought outside assistance. This assistance, I believe, was in the amount of about $138 million from the other farm credit banks, which necessitated a major restructuring and consolidation within the Spokane bank.

Now, in an October 25 memo from the Spokane District Farm Credit Council, the statement, and I quote,

> The Spokane Farm Credit District is now one of the stronger districts, thanks to the financial assistance provided to the Federal intermediate credit banks by the other system banks.

Is this true, the statement?

Mr. WILKINSON. Mr. Edwards, please.

Mr. EDWARDS. I think that Spokane's financial strength has been improved materially. Whether it's one of the stronger districts or not, I would have to go back and check. I suspect that it probably is because most of its nonperforming loans are now out of its portfolio.

Mr. STALLINGS. All right. Then, finally, from all the indications that we're getting on this subcommittee is that the farm crisis is not going to get any better. In other words, we're going to have the continued deterioration of land values, commodity prices are still going to be low. Will we be revisiting this issue again in 2 or 3 years if this prognosis is, in fact, accurate?

Mr. WILKINSON. Mr. Stallings, I think what we have evidenced this morning is that we believe what we are proposing is a means by which the Farm Credit System can hopefully get over its present threshold of severe adversity. If, as you and I are worrying about, there is no improvement in the agricultural economy, it is my prediction, sir, that you will not only have the Farm Credit System, you will have the commercial banking industry and you will have rural America back in the Congress in 2 to 3 years because of the plight that will be evidenced at that time. And it will not be restricted to the rural community, it will have a significant impact beyond that area.

Mr. STALLINGS. All right. Thank you, Governor Wilkinson.

Thank you, Mr. Chairman.

Mr. **Jones** of Tennessee. Thank you, Mr. Chairman.

Now I yield to Mr. Franklin 5 minutes for questions.

Mr. **Franklin**. Thank you very much, Mr. Chairman.

Governor, what concerns me more than anything else about your proposal is that the Farm Credit System is only a portion of the problem of farm credit in America. The other sectors, of course, the FmHA, insurance companies, and commercialized banks also are experiencing the same kind of difficulty that your system is experiencing, maybe not to the same extent.

My concern is that if we do what you propose, then we have only fixed one part of the problem. And in that connection, do you feel that there is any role for the Farm Credit System in participating with the other arms or branches of farm credit in America in helping to solve the problem? Specifically, with the Farmers Home Administration there is an attempt here, probably a worthy attempt, to move direct Federal money into that system and use the guaranty system in trying to shift that over to the private sector, which you have considered in the past to be.

Would the Capital Corporation, for instance, as you think it will be, will it be available to commercial ag banks and to the Farmers Home Administration to send troubled loans so that we can restructure and maybe use some form of Government guarantee through Farmers Home to help those other parts or arms of the credit system in the country? Or can it be used for that?

Mr. **Wilkinson**. Mr. Franklin, as you have indicated, this is not just a Farm Credit System issue. As I have indicated over the years, there has to be, I think, good cooperation and coordination and participation between all parts of the commercial agricultural credit picture, and that includes commercial banks as well as the system itself.

I think you will hear from those who are representing the commercial banks that they are concerned about the strength of the Farm Credit System, for many of them have participated very closely with the institutions, especially on the land bank side, which is a significant part of the system.

Now, the proposal that we have brought to you today directly addresses the use of a mechanism inside the Farm Credit System and existing Capital Corporation. Our authority is restricted to the Farm Credit System and our role in regulating, supervising, and examining. We at the same time, however, recognize commercial bankers may have a need for some mechanism similar to this, and I think all of us would be hopefully cooperating with a changed Farmers Home Program.

I think, second, that while this proposal may not directly be the mechanism used for commercial banks, they may have the same opportunity to establish a holding corporation of some kind within their own structure. This one is inside the system.

Mr. **Franklin**. I understand that. But you do realize the necessity maybe for some other branch of the system to have some Federal assistance in order to stabilize farm credit in the country. Would it not be easier, simpler, and more efficient to establish one of these holding companies or capital corporations to be available to all lenders who find themselves in the same situation you are with problem loans so that the farmers who will eventually benefit from anything we do here will have access to that if they have not traditionally been members of the Farm Credit System in the past?

Mr. **Wilkinson**. I think the alternative then would be to establish outside of the system a quasi-corporation that would be able to serve all commercial lenders who would be interested. I think then the determination of the Congress would have to be to whom would it be accountable, what would be the relationship between the Farm Credit Administration and its role with the system, and the Comptroller of the Currency and others who would be involved in the relationship with those total banks.

Mr. **Franklin**. Recognizing that problem as you just indicated to me that you did, would you, as the Governor of the Farm Credit System, be willing to assume a role of leadership in saying to the rest of the branches of farm credit in America that, "Yes, we realize your problem, and the Congress cannot solve our problem without at least considering yours too and maybe coming up with a total package for everyone"?

Mr. **Wilkinson**. I don't think I am in a position to be able to indicate whether the Congress would grant, or whether the Federal board to whom I am accountable, would welcome the privilege of serving beyond the area that it is designated in the statute itself.

Mr. **Franklin**. Thank you, Mr. Chairman.

Mr. **Jones** of Tennessee. Thank you very much, Mr. Franklin.

Now the Chair recognizes Mr. Daschle for 5 minutes.

Mr. **Daschle**. Thank you, Mr. Chairman.

I have been on the committee for about 7 years, and I don't recall any time where I have felt the crisis in agriculture, and especially in the Farm Credit System, was any worse.

As I have tried to analyze it, I have broken the issue down really to two areas, to two problems: a substantive problem and a perceptive problem.

Substantively, I think everyone understands that this problem is caused by bad debt, but the bad debt then is caused by a lack of income among farmers. So, I don't think there is any way that you could have answered the question Mr. Edwards asked earlier about how much you need, because no one knows how long this situation is going to last. No one knows for sure how grave the situation is going to be for what length of time. And because we don't know any of those questions, nobody is going to be able to put a figure on this for some time to come.

I think that the substantive problem is not being addressed until we deal with the substantive income problem. But to help you is like spraying the tops of trees green while the roots rot. And I think that to help you, whether it's with $5 or $10 billion, is to pour money into a funnel while it pours out the bottom.

I think the perceptive problem is equally as important. The perceptive problem goes back to the analogies so many people use in times of crisis, and that is that we're like the *Titanic,* and with all the segments of agriculture being on the *Titanic.*

Last winter farmers came to the Congress screaming for assistance. And I frankly felt somewhat disappointed that the Farm Credit System didn't do more to express the difficulties, that they didn't do more to help us during that time of crisis. You gave us some direction, but I can't recall once when a speech was made and the time was designated for assisting us during that credit problem that we faced then.

So, now, with the *Titanic* sinking, the Farm Credit System is attempting to swim to safety. And again, it seems perceptively that there is little concern for the farmers themselves and their lack of income.

In your introduction, Mr. Wilkinson, you list that there are three actions necessary to solve this problem, and, frankly, I am disappointed. In listing those three actions necessary, there is not even lipservice given to the fact that we have to improve income, that there is a dramatic need for income if we're going to solve this problem at all.

So, as a result of that lack of attention given to the farmer himself, time after time when I go back to South Dakota, farmers are saying that they're not very sympathetic, frankly, and that they're very angry at this seeming division that you put between your problem and the problem that farmers are having at the local level both with regard to their lack of income and in regards to the problems that they are having with their local PCA's and Federal land banks.

I think that anger is a real problem, and I think that unless we deal with the perceptive problem—that you are in some way separating yourselves from the plight of the farmers, that you do not give the same attention to their side of this crisis that you are to yours—that bailout just isn't going to fly. I don't care whether the President supports it or not.

I don't care whether you've got people uptown that are going to come clamoring to make their case. If you can't put the finger on how much you need, but more importantly, if you can't put the finger on the real source of the problem that we're facing right now, I am only speaking for myself, but I can't be very sympathetic. I think we are all in this together, and I think it's extremely important that more than this thick document you have given us this morning, that you have at least one sheet of paper that says we've got to understand the farmers' needs as well and we've got to work with them to come up with a comprehensive plan.

I would like if you could, in what limited time remains, to respond to that. And I know I have used the bulk of my time for a speech rather than a question. But I think, starting out, it's important that we understand each other. And as just one member, it is, I think, crucial that we address this problem at a hearing like this.

Mr. Wilkinson. Mr. Daschle, I cannot refute what you say at all. I cannot argue with you. I can think back on speech after speech in which I have said that credit is not the problem, it's income. I have said it time and time and time again.

I had hoped that today that had already been assumed by this committee, that that is a basic problem and that you knew that the basic problem of the Farm Credit System and its borrowers was the agricultural economy itself, the income situation.

Now, I think then I would go on to say that I am here today, not playing the role, sir, as the Secretary of Agriculture, even though I am vitally concerned with the points you make, I came here today as the head of a regulatory agency that is very concerned about trying to preserve a farmer-owned mechanism so that those farmers will at least, while they are trying to improve their income, will have a mechanism to secure credit.

Mr. DASCHLE. Well, I am out of time. But I just wish you would have been here a month ago when we had a golden opportunity to improve income in various ways, and I didn't hear one word from the Farm Credit System in support or in opposition to any of the proposals that were designed to improve income. And I am sorry about that.

But I thank you very much.

Mr. WEAVER. Would the gentleman yield?

Mr. DASCHLE. If I have time remaining.

Mr. WEAVER. I would just like to associate myself with his remarks—the gentleman thinks the same way I do—and ask him if he doesn't think there is a whole fleet of financial *Titanics* out there, not just one?

Mr. JONES of Tennessee. Thank you very much, Mr. Daschle.

Now the Chair recognizes Mr. Tallon for 5 minutes.

Mr. TALLON. Mr. Chairman, thank you.

I just want to follow along a minute the line of Mr. Franklin's questioning, and then Mr. Daschle, and then I would like to yield Mr. Daschle some of my time if he would so desire. He really touched on some of the things that frustrate me so much with the Farm Credit System.

I think there is a responsibility to become more involved in expressing our problems, that there are a lot of people, it's not only the producer and it's not only the Farm Credit System, it's the Farmers Home Administration. We've tried to work with the Farm Credit System to see how this subcommittee could devise a guarantee from the Farmers Home Administration that you could work with. And we just haven't had the kind of cooperation we need.

We met with the Farm Credit System—Mr. Thomas, myself, I know Mr. Stenholm and maybe others, certainly Chairman Jones—a year and a half ago. And you wouldn't even acknowledge that there was a problem. And now the whole thing is just absolutely coming apart.

We've got savings and loans out there that are in trouble, thrifts, other banks, and we certainly have a crisis in agriculture.

What is your loan portfolios in the Farm Credit System? How much money is owed to the Farm Credit System?

Mr. WILKINSON. The total volume outstanding is $74 billion, Mr. Tallon, $74 billion which the farmers of America have borrowed, have secured from the financial community.

Mr. TALLON. That $74 billion represents what percent of the total?

Mr. WILKINSON. It's about one-third of the total farm debt, sir, producer farm debt.

Mr. TALLON. With this line of credit in the recommendations that you've made to this subcommittee today, what do you foresee, what can you project as far as interest rates are concerned for the farmer? Right now your interest rates are higher than commercial banks. Is this going to help that situation?

Mr. WILKINSON. One of the difficulties which the present stress in the Farm Credit System is evidencing is the concern on the part of the investor, and whereas in the past the spreads between farm credit security cost and those of the treasuries have been very minimal—best of all of the agencies, as a matter of fact. They have now increased to the point where they are some 100 to 125 basis points above treasuries.

This proposal we have this morning would again bring the Government into an acknowledgment that it does have a responsibility because this is one of the financial agencies, and that assurance we would most sincerely hope would evidence to the investment community that the risk is not as great as they were originally anticipating, thus bringing that spread down, thus being able to pass a degree of that back to the borrowers themselves, alleviating to some degree the cost of interest or the cost of the credit.

Second, the proposal that we have, consolidation through the Capital Corporation, would spread that debt load management throughout the broader system, and in many cases that we would hope that too, removal of the debt load from that lending institution, would enable it to have better service and better rates to the producer.

Mr. TALLON. Governor, I want to do anything and I want to support anything that this committee can do and this Congress can do to help my constituents that are absolutely struggling for survival.

What is the situation going to be in a year if we go along with these recommendations, in your opinion? You know, things just essentially don't look very well out there. Is this just a stopgap measure? How are we going to work out of this?

Mr. WILKINSON. Again, Mr. Tallon, what brings us together today is an effort to try to have that farmer have a source of credit from his own institution. We have not talked here today, as evidenced by Mr. Daschle so articulately, we have not talked here today about what the milk price is going to be or the price of wheat or the farm market in Europe or wherever it is. What we're trying to do is to still preserve a credit institution while all of us work out the basic problem of farm income.

Mr. TALLON. Well, Governor, I want to preserve that credit institution. But when I go back to South Carolina and I am talking to my constituents, I want them to feel like there is some sensitivity on the Farm Credit System's part to their problems, to their concerns. And frankly, that is not what I am seeing when I go back. There is a great deal of animosity. We've had meeting after meeting after meeting in South Carolina with farmers, with the Farm Credit System, the PCA's and the land banks. We are not getting the kind of cooperation we ought to get.

I want to try to help, but I want to see some sensitivity on the Farm Credit System's part, and I want to see the Farm Credit System help articulate this problem we have. We have got to have more farm income.

Mr. WILKINSON. Thank you.

Mr. JONES of Tennessee. Thank you very much, Mr. Tallon.

Now, before the Chair takes his 5 minutes, I am going to recognize the chairman of the full committee, since all subcommittee members have been heard for the first round, and then recognize some other members who are sitting with us today.

Mr. de la Garza, you are yielded whatever time you may wish.

REMARKS OF HON. E (KIKA) de la GARZA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

The CHAIRMAN. Thank you very much.

Governor, let me say that the baseline of where we start, all of us agree, is that the farmer didn't have enough income to pay on his loans. It's very simple.

I was asked by one of the major networks to expound on the problems of the Farm Credit System, as when you have someone who loaned the money and someone who borrowed it didn't have enough, this didn't make the 6 o'clock news because it was too simple. [Laughter.]

The problem is, where do we go from here? And I may be playing the devil's advocate, but I have been out in the countryside every weekend in one part of this country or another, and what I hear—I was told it privately, I am saying it publicly—what I hear from the president of this bank and the administrator of the Farm Credit System and what I hear here in Washington is not what I am hearing out there.

Mr. Swackhamer, from Baltimore, in his statement says, "They are a group of farmer-owned and farmer-directed, locally based farm lending cooperatives knit together by a common charter act, a common regulator, and their coresponsibility and obligations issued through a common funding source."

That's not what they're saying out there. The ones that are stable say, "Hey, we're not responsible because somebody didn't manage properly." The ones that are suffering say, "Hey, if it goes 1 percent higher in interest, I am bailing out."

So, the system, the farmer-owner borrowers that you and all of us so proudly point at aren't happy out there. They're all dissociating themselves from the mess, from the ones that are working and from the ones that are not working.

So, I think that we'd better find out if they want a system that says here what it is, because I am not satisfied that they do, because the ones that are in trouble—night before last, in Kenosha, WI, a farmer symposium where I was attending wanted to know if the interest was going to go up 1 percent. I said, "I don't know." He says, "If it goes up 1 percent, I'm bailing out. I'm bailing out."

You in your statement say, "The Farm Credit System is a stable and reliable source of competitively priced credit to creditworthy farmers, ranchers, and cooperatives."

Now, according to all of your assessments here, and from several of the statements that I have read, you are not going to hold it down to 1, 2, or 3 percent. So, once your interest goes beyond that, nobody is going to want to be a part of the system. The pride that all of you here testify to doesn't seem to be out there.

Now, in your estimation, Governor, if we do the things that you ask us to, where will the interest rate be, under the assumptions that you make today?

Mr. WILKINSON. I think the way to answer that, Mr. de la Garza, would be, first you have to start with what would the cost of money be on the money market, and then accepting whatever that is—because that is not determined by the Farm Credit System or the system, that is the marketplace—then our concern is to have as narrow a spread between that and other sources of funds as possible so that that spread may be passed on through the financial institutions back to the farmer.

But when the system has to go to the market and pay 1, 1.25, or 2 percent more because there is no program of the Congress or the administration or there is no evidence of the administration that it is going to stand ready to support, then that additional cost has to also be passed back to the farmer. And truly, as you pointed out, the system becomes noncompetitive.

The CHAIRMAN. Let me ask further now. A statement from the bankers now. The bankers, or part of the bankers, are saying that if you bailout—I hate to use the word "bailout"—but if you assist, then you have to assist us out here.

Another statement says—I think Mr. Swackhamer also said that—"The consequences if the system were to fail, the consequences throughout rural America, the impact on the local bankers, all of that is catastrophic." But the question still remains. Can the private system—the National Bank of Ottumwa, IA—can they secure funds, everything being as it is today, at a lesser rate of interest and pass it on at a lesser rate of interest than you could, even if we do everything you ask?

Mr. WILKINSON. Mr. de la Garza, in many cases they can, and the reason is that many of them are not carrying the debt load that the farmer-owned credit system has accrued, because the system stayed with its farm community and its borrowers during the early to late 1970's, early 1980's. And the system, second, does not have the variable sources of funding that the commercial bankers do.

The CHAIRMAN. Well, I regret that we have so little time, but I would suggest to you and to the members of the system, all the bank credit presidents, and all of the people that come here to Washington, that you have a public relations problem out there. They are not saying what you are telling us here, and they are not as proud of the system as you say and we think they are, and they are the ones that are jumping out and the other ones are saying, "That's not my baby."

One of them I spoke to, I said, "You are a member of an entity, and the charter says and the regulations, everything says that you are responsible." He said, "Nobody told me that." And I said, "Well, it's there." He said, "Well, then somebody lied to me."

I think before we move any further with what you're suggesting and what all of us are discussing—and I have told the chairman of the subcommittee, even if he has to go out into the countryside for more hearings—we have got to document whether those farmer-owner investors want the system to continue or not. I am not satisfied now that we have a clear picture.

Thank you, Mr. Chairman.

[Additional information submitted by the Farm Credit Administration follows:]

Farm Credit Administration

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McLean, Virginia 22102-5090
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November 15, 1985

Honorable E (Kika) de la Garza
Chairman, Committee on Agriculture
House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

This letter is in response to questions you raised at the October 30 hearings of the House Agriculture Committee's subcommittee on agricultural credit. We appreciated the opportunity to appear before this subcommittee to discuss the continued competitive viability of the Farm Credit System (System). We look forward to working with you and other committee members in addressing the issues raised at the hearing.

You expressed concern with the System's commitment to serve the needs of its member-borrowers in these uncertain economic times and the grassroots perception of the System's and Farm Credit Administration's (FCA's) intentions of how to maintain an effective credit delivery structure as an integral part of rural and agricultural America. A question was also raised on the System's ability to remain competitive.

Commitment to Agriculture

The System was established over a period of years to provide a dependable source of adequate credit to agricultural producers. Inherent in the structure of the System was the recognition that agricultural producers needed a lender who understood the dynamic problems of an industry that is dependent on weather, market conditions, and political realities beyond its control. Despite wide swings in commodity prices and agricultural land values, the diverse changes in farm population, and a shift in size of farming operations, the need for the System has not diminished. The farm sector still requires assurance that credit will be available in all geographic regions, in good times and bad, and at minimum cost to the borrower.

It is our belief, as the regulatory agency, that the unique funding mechanism, the cooperative structure and philosophy, and the local representative involvement of member-borrowers of the System is still the effective means of meeting the agricultural sector's credit needs. The government's original faith in farmers as both managers and owners of democratically controlled financial organizations has been vindicated many times in the past 50 years.

NOV 15

Today's financial difficulties in agriculture neither violate the early principles used to establish the System nor impugn the ability of farmers to manage financial cooperatives to fulfill the public interest and the needs of rural America. The existing economic environment does, however, make the responsibility of efficiently managing credit cooperatives a difficult and often painful, stressful process for many local and district boards of System institutions. These elected directors are expected to address the fiduciary responsibilities of business operations while operating within cooperative philosophies. Unfortunately, the magnitude of some of today's problems are a direct result of elected directors not making the necessary sound business decisions in time.

A "we-they" relationship does not exist in cooperative organizations such as the System. The owners and the users of the System are one and the same. Yet it is a frustrating truth of this decade that not all agricultural producers will remain in operation. Thus, when a cooperative lending institution forecloses against a borrower, the unfortunate action is taken in recognition of the interests of fellow member-borrowers as a whole.

There is no question that some of the steps taken by System institutions to cope with financial stress and to forestall future difficulties are unpopular with certain borrower groups. Self-control carries with it a recognition of financial obligations, sound business management, and compassion. To the extent that FCA, as the regulator, allows System institutions to do so, we feel the System has been sensitive to the problems of many disgruntled and unhappy borrowers who have had foreclosure proceedings initiated against them.

In retrospect, the practiced forbearance of System institutions over the past few years probably did more harm than good as farm equity values plummeted and the System's loan losses soared. The System's generally liberal policy of forbearance resulted in many borrowers exhausting their capacity to continue a viable operation. In some cases, borrowers no longer have equity left. This damages the equity position of the System bank or association, which has an additional impact on all other member-borrowers.

Continued Need for the System

Despite the changes in a deregulated financial environment, the System's fundamental role in providing mortgage financing cannot be overemphasized. Federal land banks now provide more than 40 percent of the mortgage debt to agriculture. Life insurance companies, previously the dominant institutional lender, have demonstrated a growing preference for nonfarm investments. Most of their farm lending focuses on large loans of $1 million or more. Commercial banks expanded their real estate lending in recent years, but the terms and maturities of their loans are not conducive to the long-term financing needs of agriculture. In addition, the liability structure of commercial banks greatly limits their ability to do much more than satisfy some long-term credit needs at the margin.

An often overlooked but important credit service to rural America is provided by the banks for cooperatives. These banks provide more than

60 percent of the credit used by the supply, marketing, and service cooperatives that serve a broad spectrum of U.S. agriculture. Again, the credit and financially related services are carefully tailored to meet the specialized needs of farm cooperatives. The absence of this credit delivery mechanism now embodied in the System would create a void that other lenders could not fill. Such a lack of access to credit would be detrimental to our whole society, but particularly to rural communities and economies.

Inasmuch as the System can maintain its competitiveness in short-term lending to provide operating capital to agricultural producers, this service is a vital component of the total credit needs of the agricultural sector fulfilled by a cooperative structure.

Maintaining the System's Competitive Position

There are fundamental differences between the System's funding mechanism and the "prime rate" of commercial depository institutions that must be recognized, particularly in light of the macroeconomic policies that have resulted in reduced inflation, greatly decreased land values and a strong U.S. dollar.

The System's interest rates are driven by the Nation's financial investment markets. The cost of borrowing that is passed on to agricultural borrowers is established by the investors' confidence in System securities and their willingness to take risk. While System securities have traditionally traded extremely close to U.S. Treasury notes, the price spread between System securities and U.S. Treasury notes has widened in past weeks. This increased spread, which obviously contributes to higher borrowing costs to System member-borrowers, can be expected to continue as long as uncertainty about the System exists. It is for this reason that FCA is urging timely action by Congress and the Administration to reduce the unwarranted costs to farmers that will surely result as a consequence of investor uncertainty.

Another factor that affects the System's competitive position today is that it has based its interest rates to borrowers on an average price of outstanding securities. That is a major factor in the System's ability in the late 1970s to offer credit at 11-12 percent when the prime rate jumped up to 18 and 21 percent. While this average pricing provides a more equitable and stable interest rate to members of a cooperative, it builds an inherent lag in the decline of System interest rates in relation to interest rates tied to the "prime rate," as our economy maintains low inflation and single-digit rates on U.S. Treasury notes.

We must point out that public sector assistance to the System cannot, in and of itself, guarantee that the System will be able to offer credit to all creditworthy producers in all geographic regions of the country at rates consistently below other lenders. Congressional action that assures the investor market and calms rural America over the uncertainties of a financially weakened credit delivery mechanism will certainly help the System to maintain its competitive stance and continued service to the agricultural sector.

Other Contributions of the System

The System has been and remains a vital source in improving the welfare of farmers, rural communities, and consumers in the United States and throughout the world. Farmers and ranchers — the users and the owners of the System — have benefited both directly through improved living standards and indirectly through learning how to deal with the economic and financial realities of agriculture as a business.

Much of the abundance we enjoy in the United States is a direct result of the huge productivity gains that have been achieved in agriculture during this century. The adjustments that have been necessary in these dynamic changes could not have occurred without the availability of credit to facilitate the process. Clearly, adequate credit at reasonable cost must be available if the remarkable changes in farming techniques that have already occurred are to proceed smoothly.

The Farm Credit System enhances the well-being of rural America by increasing the total supply of credit to the farm sector. It serves as an important financial intermediary by channeling outside funds into rural communities, thereby augmenting local sources of funds to support the farm-related business that comprises much of the rural economy. Without outside funds, interest rates to farmers would tend to rise -- especially during "tight money" periods. The System's existence has been beneficial to other lenders, allowing them to increase and improve their service to agriculture through various business relationships with System institutions.

We hope these comments demonstrate the vital role of the Farm Credit System to U.S. agriculture and the general economy. As a credit delivery vehicle to agriculture, the System has served the public interest very well. It can continue to do so in the future.

Sincerely,

Donald E Wilkinson

Donald E. Wilkinson
Governor

Mr. JONES of Tennessee. Thank you very much, Mr. Chairman.

Now the Chair will take some time to ask a question or two.

My first question, Mr. Chairman, is—and I realize that I am going to try to confine my questions to something that pertains to the Farm Credit System and/or the council because I know the next witnesses will be more in position to answer some of these questions then you could be, since you are regulatory.

But I feel, although my first question is sort of conjecture, that no doubt you have some idea as to what your opinions are because you have attorneys and you have counsel that would help you on this.

The question is, How confident are you that your recently publicized and published emergency regulation concerning capital transfer authority would hold up under challenge if you were to implement it?

Mr. WILKINSON. Mr. Chairman, that is a legal question. May I have our general counsel respond?

Mr. JONES of Tennessee. Well, that's the reason I hesitate to ask, but I think this subcommittee deserves to know.

Mr. WILKINSON. It is a very important question, Mr. Chairman.

Mr. Medero.

Mr. MEDERO. Thank you, Governor.

Mr. Chairman, a great deal of time and a great deal of thought went into the regulation before it was proposed to the board, and it was thoroughly discussed with the board at the time it was adopted by the board.

We feel confident that the regulation is on solid legal basis and that it will be successfully defended. We have had two opportunities to start dealing with that issue. The first instance has come up in Ohio where a suit has been brought against a production credit association in the Louisville district in which we have been named as defendant. We have been successful in the first round of resisting a temporary restraining order. The judge has looked favorably upon our arguments in defending the regulation.

In addition, a case was heard last week in the Spokane district, particularly in Idaho. Again, a production credit association sued the Spokane banks and the Farm Credit Administration, seeking a preliminary injunction. And we were again successful in resisting that preliminary injunction, the judge ruling favorably at least at that stage in terms of the validity of the regulation.

Those proceedings are not over. They will go into additional proceedings. But we are confident at the end of the road that we are on solid legal ground in being able to defend that regulation as a proper extension of the Governor's specific authority under the statute.

Mr. JONES of Tennessee. Well, now, as a followup to that, how does your legislative proposal to provide the Capital Corporation with authority to pool system capital different from what you are doing today with your current emergency regulation?

Mr. MEDERO. Mr. Chairman, the proposal with respect to the Capital Corporation would give FCA the authority specifically in the statute to back up the system in bringing its capital resources together into one place. The existing regulation would be further developed in the proposal by reducing it to a more elaborate and a more specific statutory requirement that FCA, after the system has its opportunity to pool its capital resources and make its capital available to deal with its problems, that FCA would have an oversight role in that process and in the eventuality that it was unsuccessful on the system's part, that the agency would have the specific authority to cause that pooling to take place.

So, it would be an extension of the existing regulation, bringing it over from the regulatory side into a specific statutory provision which would be more comprehensive than the existing statutory provision.

Mr. JONES of Tennessee. Thank you very much.

Now back to you, Governor. Governor, are you convinced that the Congress should act on the FCA regulatory legislation and Farm Credit System assistance before we adjourn this year? I know that's a big one, but we're going to have to face it. Or do you believe this situation can afford to linger until next March or April—and that's about the history of what we do here in Congress the second year—which is probably as soon as we could get to it in 1986?

Mr. WILKINSON. Mr. Chairman, the delay of the proposals which we brought to you this morning by the Congress can be interpreted into literally millions of dollars of additional cost to the farmers who secure funds from the Farm Credit System.

The reason for that is the one that we have stressed, several of you and I have indicated this morning the market, the investment community needs assurance that there will be something stabilizing this critical farm credit issue at the present time. That needs to be done immediately, Mr. Chairman, as well as the total package which we brought to you. It's a dollars-and-cents impact upon the American farmer.

Mr. JONES of Tennessee. Thank you very much, Governor. I appreciate the answer to all three questions.

Any other comment from any of the people who accompany your group?

Mr. WILKINSON. No; thank you.

Mr. JONES of Tennessee. Now, before I recognize Mr. Coleman for the second round, I would like to recognize some members of the full committee who are with us today: Mr. Arlan Stangeland from the State of Minnesota.

Arlan, we are delighted that you are here.

Also, Larry Hopkins, who is here from the State of Kentucky, who are vitally concerned with this problem.

And the delightful Virginia Smith, from the State of Nebraska, who has a few problems in the State of Nebraska regarding credit.

Also, Doug Bereuter from his State of Nebraska.

So, Doug, we are glad that all of you are here, and I will give you 60 minutes to just ask a question.

Mr. BEREUTER. Sixty seconds.

Mr. JONES of Tennessee. Sixty seconds to ask a question. [Laughter.]

Arlan, you go first.

REMARKS OF HON. ARLAN STANGELAND, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MINNESOTA

Mr. STANGELAND. Thank you, Mr. Chairman.

First of all, I want to thank you for holding these hearings. I want to thank the Governor for appearing.

I have 60 minutes' worth of questions. [Laughter.]

Mr. JONES of Tennessee. I know you do. So do I.

Mr. STANGELAND. But I would ask unanimous consent that I be allowed to submit a series of questions in writing to the Governor.

I would urge in my 60 seconds that you, Mr. Chairman, and this subcommittee, if we're going to change the chartering law of the Federal Farm Credit Administration, that you make a very careful analysis of what is the statutory powers currently vested in the Governor and the Federal Farm Credit Board, and what powers have been assumed by rule and regulation, because many of the powers that the Federal Farm Credit Administration had are by rule and regulation, not by statute.

If we do not, they say that people who do not learn to recognize their mistakes are doomed to repeat them, and I would hope that as we write this new bill, that we try to ferret out where we went wrong and why we went wrong before we embark on passing some new law that may be only patchwork.

I think a very careful analysis of that charter and the statutory powers that the Governor has now and those that the Farm Credit Administration has assumed ought to be very clear in the minds of this subcommittee.

I thank you for the time.

Mr. JONES of Tennessee. Thank you, Arlan.

Without objection, if you submit questions they will be made a part of the record or held in the committee files.

Mr. HOPKINS. Mr. Chairman, thank you very much. Let me take a second and thank you for leading this very vital subject, for the time that you have put into it, and all of us are appreciative of the work of the subcommittee.

If I could take just a couple of minutes, I would like to ask the Governor a couple of questions if I may, and then he can respond later or now, whichever he would like.

But I think it's on the minds of a lot of people, Governor. How long have you been the Governor?

Mr. WILKINSON. It will be 9 years March 1, sir.

Mr. HOPKINS. You know, the time for really being nice is over. I don't mean to be ugly here, but I am speaking on behalf of a lot of people who would like to have the opportunity to ask you where in the hell have you been—I really mean that, I mean that sincerely—when we've got the problems that we've got out here in farm credit.

Tobacco is my No. 1 cash crop. We don't have the problems in Kentucky yet because we've got a prop that's holding it up. But it's being punctured, and people are looking at it and threatening it every day.

Now, if we lose that No. 1 cash crop, Kentucky will go spiraling to the top of this list of States that have problems. You're asking for 5 billion dollars' worth of bailout. And I am going to call it what it is in my opinion. I don't think that's going to do it. You've got a $74 billion insolvency problem, and you're asking for $5 billion. How in the world are you going to solve that problem?

As a banker, I couldn't go see my banker and say, "Hey, I've got a problem that's evolved over several years. $78 billion. But if you'll let me have $5 billion more, I think maybe I can solve this problem." I would be embarrassed to ask him for that.

I don't think it will work. I very frankly must go on the record and say to you right now, Governor, in my honest opinion, coming from a financial background, you're going to be looking at somewhere between $10 and $30 billion when all the chips are in, in my honest opinion.

I don't mean to be upset, but there are a lot of people out there who are upset. And it's not a personality thing between you and me. You and I don't even know each other. We come from different areas. But I am as concerned as anybody here. I want to continue working with this subcommittee and its chairman to do whatever is necessary. But I just don't think giving an aspirin to cure cancer is necessarily going to be the answer, Governor.

Thank you very much.

Mr. **Jones** of Tennessee. Thank you very much, Larry.

Now to Virginia Smith for a brief statement.

STATEMENT OF HON. VIRGINIA SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEBRASKA

Mrs. **Smith**. Thank you very much, Mr. Chairman.

First, I want to thank you and all the members of the subcommittee for holding this vitally important hearing.

And I would like to say to you, Mr. Wilkinson, that I had nine meetings out in my district last weekend. This farm credit problem is absolutely the No. 1 problem out in my area, where we're in probably as tough a financial condition as anywhere in the Nation.

You have had a great loss of credibility out there. It is really serious. They feel that you are not really trying to help the borrowers as much as you are trying to help the bondholders.

I have five questions that I am getting and I am getting them repeatedly and if you could answer them for the record, I would like to have them.

First, they want to know—and I know Mr. de la Garza tried to find out this answer—if you are really going to lower interest rates. I don't mean just one-quarter of 1 percent from 13.5 percent, but are you going to lower them enough to be competitive? Our good borrowers are wanting to get out because you charge too high interest.

Second, regarding the PCA's, are you going to unfreeze their class B stock? Our folks are quite upset about this.

And in the third place, they think that they're being deprived of local control, and they don't like it. They tell me again and again of meetings, district meetings, and area meetings, where they had no choice.

And then fourth, they feel that when they're pushed into this Capital Corporation, it's going to be because you want your money.

And my information is that out in Spokane they were ruthlessly pushed out and liquidated over a short period of time.

Then a last question: For these people who are now marginal, will you try to restructure those loans and keep them in, or are you going to push them out?

Mr. Chairman, thank you very much for giving me that opportunity.

Mr. JONES of Tennessee. Thank you, Virginia.

Doug.

STATEMENT OF HON. DOUG BEREUTER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEBRASKA

Mr. BEREUTER. Thank you, Mr. Chairman.

I would also like to submit mine and just summarize in the 60 seconds.

I appreciate the courtesy that is extended to me and the chance to testify at your first meeting on this important subject. I tried to make the point in that instance that what happened in monetary policy in 1981 and 1982 really had a tremendous effect in deflating agricultural land values and that fact is important to us politically here in the House and the Senate to get a solution to our problem.

The Banking Subcommittee of which I am a member began hearings on this subject last week, and I encourage your staff to present to you information from the Wharton International Agricultural Service testimony which showed the impact of this agricultural credit problem on employment in this country and on credit institutions generally, because I think it helps make the case that assistance is needed.

I have been very critical of the Farm Credit System for not coming to us in February and March when I think the problem was apparent and when we were ready to deal with it in Congress before we proceeded with consideration of the farm bill.

Also, I have to say that the proposed increases in salary in the Omaha district could not have come at a worse time, and I encourage you to look at those pay increases.

But my most important point, which will be made by one of my constituents, Bud Gerhart, chairman of the agriculture committee of the Independent Bankers Association of America, is that this subcommittee and the Banking Committee must look at the agricultural credit problems, not only of the Farm Credit System but also the commercial agricultural banks and the Farmers Home Administration. It is unfair to discriminate against a borrower who happens to have a loan with a particular type of institution. So I think we need to look at this problem in a comprehensive fashion.

I thank you and commend you for holding the hearings.

[The prepared statement of Mr. Bereuter follows:]

Statement by the Honorable Doug Bereuter
before the House Agriculture Conservation and Credit Subcommittee
October 30, 1985

Mr. Chairman, members of the Subcommittee, good morning. I wish to commend you for continuing to hold these hearings and for moving forward expeditiously in seeking a solution to our worsening agricultural debt crisis.

I spoke before this Subcommittee earlier this month, and I appreciate having the opportunity to be with you again today. I recognize you have many things which you wish to accomplish today, so I promise to make my remarks brief.

First, I want to report to you that one of the subcommittees on which I serve, the House Banking Economic Stabilization Subcommittee, began hearings last week on Wednesday on the extent and severity of our agricultural debt crisis and the impact that it poses for the rest of our economy. The hearing was attended by representatives of the Farm Credit Administration, the Federal Reserve Board and the USDA.

The focus of the this initial hearing was not so much on the solution, but rather on the consequences that will occur if the financial problems in agriculture are not addressed soon. One of the individuals who testified was a gentleman associated with Wharton's international agricultural service who more or less spelled out in numbers the impact of the "Main Street" theory on our nation's economy.

Under current conditions, the financial losses in agriculture will result in the loss of 175,000 jobs from the national workforce. The primary impact of loan losses in agriculture of $20 billion will be felt in the private credit markets as general confidence waivers. These loan losses would lead to the collapse of a substantial number of commercial banks and farm credit instituitions. While most would be small banks in the Midwest, their failure would have an impact throughout the economy because of their relationship with investors and major banks.

A further result of large-scale agricultural loan losses would force private interest rates to increase and push up the cost of capitol not only for agriculture, but also for the entire economy. This would cause a drop in the amount of investment in agriculture by several billion dollars, a reduction in our gross national product, the loss in thousands of jobs in both agriculture and non-agricultural secrtors and a reduction in personal income of several billion dollars.

The point to which this leads me is that we as members of either the Agriculture Committee, or the Banking Committee cannot focus on just a narrow solution to the financial problems in agriculture today. The debt crisis we are experiencing, and the even larger one which looms ahead of us, is not just a Farm Credit System problem. Commercial banks, individuals, rural and ag-related businiesses and the Farmers Home Administration also face billions of dollars of debt losses and nonserviceable debt.

Like it or not, we must deal with the reality that possibly as much as $50 billion of the farm debt cannot be serviced given the current outlook for agriculture. Regardless of the Farm Bill that Congress passes there is simply more debt than can be serviced under any reasonable projection of the future farm income of the individuals who owe debt.

Among ourselves we all agree that reductions in interest rates and improvements in commodity prices may help some individuals. However, given the level of our federal deficit, the impact of our monetary policy on interest rates and the money supply, and the huge bumper crops that are now being harvested, I think it would be unrealistic, if not foolish, for anyone to think that either interest rates, or commodity prices will improve in the near future.

This scenario for diaster, however, will not affect only those who are borrowers of the Farm Credit System; it will affect all agricultural producers who today are borrowing money. Thus, while debt levels must be adjusted to match debt service capabilities, this adjustment cannot be made solely for borrowers from the Farm Credit System.

While the problems of individual agricultural lenders may vary, the agricultural debt problems of all farmers and ranchers today are indistinguishible. All are symptomatic of a depressed agricultural economy.

It would be neither prudent, nor equitable to assist one farmer simply because he borrows his capital from one institution, yet permit his neighbor with the same debt problems to perish because he borrows from a different lender. Both borrowers are financially imperiled; both lenders are further weakened by defaults. And the collective impact on our economy of hundreds of such borrowers and lenders failing is more prevalent and perilous.

Many would argue that collectively the Farm Credit System is an institution which we cannot allow to fail. However, the Farm Credit System is not one collective financial giant. Rather, it is a collection of hundreds of individual cooperatively-owned banks. As such, the interests of all agricultural banks--be it a member of the FCS, or a commercial bank--should be addressed with equal and equitable concern.

The size of the institution should not be the sole criteria upon which any solution to our agricultural debt crisis is crafted. Rather, it should be the collective size of the problem.

In terms of bailouts, sheer size often seems the prerequisite criteria to justify government assistance. True, the Federal government is known for its bailouts of BIG institutions; and true the FCS is currently experiencing major problems of monumental proportions. However, the Farm Credit System cannot be compared to Chrysler, New York City, Continental Illinois, or the Penn Central. Collectively, however, the debt problems of the individual borrowers of the FCS, along with the borrowers from commercial banks and the FmHA, do represent an economic problem which makes all previous financial crises pale in comparison.

The sole point I wish to make is that any assistance which this Congress might consider cannot, and should not, be just Farm Credit System specific. We must address the problems of all lenders, and all borrowers with agricultural debt. Focusing on only a fraction of the problem will result in only a fractional solution. Focusing on the entire agricultural debt problem will produce a sound and equitable solution for all who need and require our help.

Mr. Chairman, again I thak you and the members of your subcommittee and I look forward to working with you in the coming weeks on this important legislation.

Mr. JONES of Tennessee. Thank you very much, Doug.

We have one member that was missed as we went down the line a few moments ago, and he has since returned, Sid Morrison, for his 5 minutes of recognition.

Mr. MORRISON. Mr. Chairman, I am sure that a number of these questions have been asked.

Governor, I would like to ask you directly, on the use of the revolving fund—and I know you want to use that in some way as leverage to force some other things to happen out across the system—is your primary goal with the revolving fund, if that ends up being made available to you, to keep interest rates down as far as borrowers are concerned?

Mr. WILKINSON. The primary purpose of using the revolving fund would be the mechanisms through which the funds from the line of credit from the Treasury would go to the Capital Corporation which we described as being the one which would be assembling and working out the troubled loans.

It would not necessarily have a direct impact on the interest rate, but as we have indicated earlier this morning, it would be our hope that by consolidating the bad loans in one location, alleviating the necessity of the lending institutions to spend so much time and to use their resources, that they would, therefore, be able to be more efficient and provide some alleviation of the present high cost of money at the lending institutions.

Mr. MORRISON. So there is no real assurance to those of us who might carry your proposal that we can go back to our farmers and say part of this procedure is to guarantee that interest rates charges to borrowers will not climb? That's what they need to know. We are having an erosion from the system now, as you know, and I think we need some assurance that interest rates are not going to go higher than they currently are.

Mr. WILKINSON. Our objective would be to not only stabilize but, hopefully, provide some reduction of interest rates. But I cannot sit here and promise that that will take place, because I do not know what the cost of our securities will be when they go to the market this week and on into the future.

I did indicate earlier that stabilizing the concern in the investment community can do more than any one thing to help that cost of money, Mr. Morrison, and that is the evidence that the Government stands behind, through the availability of a line of credit, which is what we are proposing. That is far more important than literally $3, $5, $7 billion.

Mr. MORRISON. I would concur. Would it help if, as a first step, if Congress proceeded to act on the guarantee, just a very simple, "Yes, we do stand behind Farm Credit System financial paper"?

Mr. WILKINSON. I think that's very important, but I think you need to look at a broader package if you are going to do anything, and that package is the one that we have brought to you this morning, or modifications thereof.

Mr. MORRISON. I was thinking of something we could get through in a hurry.

Thank you, Governor.

Thank you, Mr. Chairman. I yield back the balance of my time.

Mr. JONES of Tennessee. Thank you, Sid.

We have now completed this round of questioning, and now to Tom Coleman I yield 5 minutes for additional questions.

Mr. COLEMAN. Mr. Wilkinson, what is the size of the reserves of the system?

Mr. WILKINSON. May I ask Larry Edwards, because he has got them right in front of him, Mr. Coleman, and can share them with you.

Mr. EDWARDS. The net worth of the banks and associations at September 30 was about $5.5 billion. In addition to that, there was about $1.6 billion in reserves for losses.

Mr. COLEMAN. How much of that would you propose using as your contribution toward this Capital Corporation?

Mr. EDWARDS. Our proposal would be that the system's contribution would commit its resources, all of them.

Mr. COLEMAN. What you just told me? All of them?

Mr. EDWARDS. Yes, sir.

Mr. COLEMAN. Why is it that 2 weeks ago, privately we were talking about a revolving credit fund of $10 billion, and 2 weeks later we're talking about one of $5 billion? Not you specifically, but others of the administration?

Mr. EDWARDS. I can't answer that for others in the administration.

Mr. COLEMAN. Mr. Duncan, you and I had the conversation.

Mr. DUNCAN. Mr. Congressman, we are attempting to present to you a proposal that is austere but workable. We understand from the regulator's perspective the difficult budget problems that the Congress has to deal with, and we are sensitive as well to the need for a solution that will provide sufficient backstop to the system so that it can with good, prudent management be able to come through this difficult adjustment period and earn itself back to a level of financial vigor while at the same time instilling confidence in the financial markets so that those markets remain open to agricultural borrowers at acceptable costs.

Mr. COLEMAN. Well, I think the fact that we in a couple of weeks have saved $5 billion gives me reason to be very cautious in proceeding further as far as the timetable that the Governor spelled out just a while ago and your as far as moving this thing as rapidly as some forces would like to see it. Maybe we could wait 2 more weeks and save $5 billion more.

But let me ask the Governor, have you retained any outside financial consultants to look at your operation? And if so, did they report back to you?

Mr. WILKINSON. Yes; we have retained outside financial consultants, recognized entities within the investment community who have given us guidance as it pertains to the proposals that we have brought to you, who have guided us in searching for other alternatives of providing assistance. The answer is, "Yes, sir."

Mr. COLEMAN. And were there more than one or one?

Mr. WILKINSON. Well, we have counseled with various ones, but we did retain a particular firm, sir.

Mr. COLEMAN. Did you adopt any of their proposals, or are they in the form of your recommendations or alternatives today?

Mr. WILKINSON. They at this stage have not found their way into our specific proposal, but they may very well as the total proposals are refined as we work with you.

Mr. COLEMAN. It's my understanding that you are having an outside audit conducted by Price-Waterhouse & Co. Correct?

Mr. WILKINSON. Yes; it was the recommendation of the Farm Credit Administration 2 years or more ago that the 37 banks be publicly audited by this firm.

Mr. COLEMAN. It's the first one in 50 years as an outside audit, is that correct?

Mr. WILKINSON. To my knowledge, that is true as far as all of the 37 banks are concerned, one audit.

Mr. COLEMAN. Are they making an analysis of your nonperforming loan portfolio?

Mr. WILKINSON. Well, may I suggest that that be asked of the system, because they have retained the outside auditor, and they will be with you in the next panel here.

Mr. COLEMAN. Are you familar with your nonperforming loan portfolio?

Mr. WILKINSON. Yes.

Mr. COLEMAN. And are you anticipating that it will increase dramatically as a result of new accounting procedures that you or the system have put in place?

Mr. WILKINSON. No; I do not anticipate that it would increase dramatically—the term that you use—because we have been working closely with the system, with its public accounting firm, with our own technicians and staff, and I think we know pretty well what is out there.

Mr. COLEMAN. Because of the concern of the system—well, let me ask you this, is there an agreement between you and the Federal Reserve regarding the purchase on the markets of your securities?

Mr. WILKINSON. The Federal Reserve has long had the opportunity and has actually purchased farm credit securities as part of their ongoing process. But I would like to have that amplified by Mr. Duncan because he has recently been with the Federal Reserve and can better answer that, Mr. Coleman. He can explain that process.

Mr. DUNCAN. Mr. Congressman, there are authorities under which the Federal Reserve System could provide discount window access to the Farm Credit System. I should note, of course, that at this time there still is confidence in the marketplace on the part of investors and the Farm Credit System is able to sell its paper in the financial marketplace.

The costs of those sales have increased. The spreads have widened very substantially from the 15 to 35 basis points that were historically normal. Those additional costs, as had been noted earlier, have to be passed on directly to farmer borrowers.

Mr. COLEMAN. To your knowledge, has the Federal Reserve stepped in and purchased any securities in the last 6 weeks as a result of the inability of the arm of the Farm Credit Administration who sells these on Wall Street?

Mr. WILKINSON. No; to our knowledge, the Federal Reserve has not stepped in for that particular purpose, because the funding corporation of the Farm Credit System has been able to handle the sale of its total packages.

Mr. COLEMAN. Mr. Chairman, I see my time is up. I still have some questions, and maybe I could get some more time from one of the members.

Thank you.

Mr. JONES of Tennessee. Thank you very much, Mr. Coleman. The Chair might lend you some time later.

Mr. Weaver.

Mr. WEAVER. No questions, Mr. Chairman.

Mr. JONES of Tennessee. Mr. Daschle.

Mr. DASCHLE. No, thank you, Mr. Chairman.

Mr. JONES of Tennessee. Mr. Morrison, you may be recognized at this time.

Mr. MORRISON. I would like to reserve my time, Mr. Chairman.

Mr. JONES of Tennessee. Without question, you can reserve your time.

Mr. Gunderson.

Mr. GUNDERSON. No more questions.

Mr. JONES of Tennessee. Mr. Stenholm.

Mr. STENHOLM. Governor Wilkinson, on page 15 of your prepared statement you stated you specifically request that "FCA be granted authority to issue cease-and-desist orders and temporary cease-and-desist orders, remove or suspend officers, directors, or other persons paricipating in the affairs of institutions."

Some would draw a conclusion from that statement that there has been something happening in some institutions or associations that, had you had this power, you would have, in fact, made some changes to prohibit some of the problems some of the associations find themselves in today.

My first question to you is, in your judgment, what has caused some of our district banks, some of our individual institutions to get into more trouble than others, financially?

Mr. WILKINSON. The failure to be able to make decisions fast enough and to make decisions that pertain to correction of unsafe and unsound credit administration, Mr. Stenholm.

Mr. STENHOLM. Why are some district banks in more trouble than others? Why are some States having more troubles than others?

Mr. WILKINSON. Part of it is, of course, the geography that they are attempting to serve. But that is not behind your question. Part of it is improper administration, and I will refer to the Spokane district, where they were granted the opportunity to provide credit to commercial fishermen at a time when some of those who were involved at various levels failed to adhere to the same credit standards for commercial fishermen that they were requiring of farmers.

Mr. STENHOLM. Where were you at that point in time when those decisions were being made in Spokane?

Mr. WILKINSON. The Farm Credit Administration in 1978, Mr. Stenholm, through its examination process, documented this particular concern and problem and laid it on the boardroom table of the Spokane district board, and was unable to bring about a decision of that board to correct that issue.

The old process that we have been living with and the one that we would like to correct is one which caused negotiation, arbitration, time-consuming situations, and we could not get their attention, sir.

Mr. STENHOLM. All right, that's one specific. What are some other reasons why some district banks find themselves in deeper trouble and in need of assistance when others do not?

Mr. WILKINSON. Mr. Edwards, would you wish to add to the ones that I have talked about?

Mr. EDWARDS. I think some of the problems that the Louisville district is experiencing, particularly that they experienced in the early part of this economic environment, were directly related to mismanagement in some associations. There are a number of associations in Kentucky, Ohio, and Indiana that are in financial trouble for that very reason.

There is a correlation between the magnitude of the problem and the decline in land values, though. So there are contributing factors from management, but I don't think you can blame all of the problem on that factor.

Mr. WILKINSON. Mr. Stenholm, I think we also have to give proper recognition to those areas that are very concentrated in certain types of agricultural production, and I speak now of the Omaha district, with an intensive grain industry, the lowered prices, the loss of market of grain, livestock industry which is also suffering, and we cannot overlook those kinds of major problems as these lending institutions, including commercial banks, face.

There have been many commercial banks liquidated, foreclosed, resold, in the Omaha district in addition to the farm credit problems.

Mr. STENHOLM. At any time in the last 10 years did you or anyone in the Farm Credit Administration possibly contribute to some of those, which hindsight today suggests were bad management decisions?

Mr. WILKINSON. Yes, I presume that is—that is something that has taken place because we are an agency that has a large number of people, and they, I think, at times were not aware of what the impact of their decisions might have been in the long run. They thought it was the right answer short run.

Mr. STENHOLM. Was there at any time an effort on the part of the Farm Credit Administration to promote volume?

Mr. WILKINSON. To promote volume? And your specific word was "the Farm Credit Administration," to promote volume?

Mr. STENHOLM. Or in the Farm Credit System.

Mr. WILKINSON. Oh, then that's a different question, and the answer is, "Yes."

Mr. STENHOLM. But the Farm Credit Administration?

Mr. WILKINSON. I cannot answer that because there may very well have been, but I cannot think of specific instances——

Mr. STENHOLM. What about you personally?

Mr. WILKINSON [continuing]. Whereby I personally endorsed the expansion of volume.

Mr. STENHOLM. You cannot remember——

Mr. WILKINSON. I do not remember any time that I have been involved in anything of that nature.

Mr. STENHOLM. No further questions.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Stenholm.

Mr. Gunderson, have you been recognized?

Mr. GUNDERSON. Mr. Chairman, you were kind enough to recognize me just a minute ago, and I passed at that time. But I would like to hear the Governor's speculation on what the scenario of events would be if, as the chairman indicated earlier, in essence, this Congress does nothing.

If we can't agree on a solution and we get hung up in timetables, if we get hung up in disputes with the administration, we get hung up in jurisdictional disputes, if there is no Federal assistance, what happens, and when does it happen?

Mr. WILKINSON. You go back, Mr. Gunderson, to my alternative 1, which I covered so briefly because I didn't want to direct too much attention to that, but you are proper in coming back to it. One, it would leave the Farm Credit Administration, its Federal Board, the entire Farm Credit System in a very serious period of indecision.

It would literally have no choice but to begin taking far more stringent efforts to try to preserve its remaining capital, and this would be, unfortunately, a look at where there would be the ability to eliminate some of its institutions that are not functioning effectively or are causing costs to the rest of the system.

Two, and it should have been No. 1 but I have already stressed it—no action will cause literally millions of dollars in additional costs at the interest rate side in the investment community because of what several of you have already addressed here this morning.

Confidence in the system and the Government standing behind it is extremely badly needed.

Mr. GUNDERSON. Does no action by the Federal Government leave no option but eventual dismantling of the entire system?

Mr. **Wilkinson**. No; no action by the Federal Government at this time will only cause the system to be as businesslike as it possibly can. It may very well create a liquidity problem, the inability to secure funds, literally not have any funds available. And it goes back to Mr. Coleman's question regarding the Federal Reserve and its standby authority.

Inaction at the present time, I really believe, would cause far more pressure out in the community to eliminate those nonproductive farmer loans that are truly a burden on the rest of the borrowers of that cooperative system. It does not provide the system, in other words, more opportunity to have an orderly workout program.

Mr. **Gunderson**. Would you project that there would be any point in time in which the Farm Credit Administration or the Farm Credit System itself would have to declare the entire system insolvent?

Mr. **Wilkinson**. That goes back, Mr. Gunderson, to the timeframes that we have used rather consistently, and that is, 18 to 24 months. I indicated in my opening comments the system is not insolvent today, the system is very salvageable, but it needs assistance. But 24 months from now, after it has absorbed possibly over $13 billion of troubled assets, it may at that stage be having to be declared insolvent.

Mr. **Weaver**. Would the gentleman yield?

Mr. **Gunderson**. I will yield.

Mr. **Weaver**. Well, I would like to point out the other side of the coin. The picture is certainly bleak. But as I intend to oppose any bill that has Government money, either guarantees or cash, in it, until the whole financial picture is resolved. I would like to point out that if we give money here and start bailing out every single bank problem there is with the foreign loans, the savings and loans, as real estate values continue to fall, the U.S. Treasury is going to go insolvent, if it's not already.

Only we have a printing press, and all we would be doing is fueling that fleet of *Titanics* with Treasury paper, and I just want to point that out.

Mr. **Gunderson**. I appreciate the gentleman's comments, but I think most of the other financial systems do have some kind of a guarantee agency, which doesn't exist for the Farm Credit System.

Mr. Chairman, I yield back the balance of my time.

Mr. **Jones** of Tennessee. Thank you very much, Mr. Gunderson. Mr. Thomas is recognized.

Mr. **Thomas**. Thank you, Mr. Chairman.

I tell this little story respectfully, but I can't help but recall back, I think it was about 1976 or 1977, when I went over to Columbia, appointed to the Roecroft Advisory Board, one of the meetings that was held there, and Mr. Darr at that time was head of the Columbia Land Bank, and he was a nice fellow and a man I respected very much. He is missed today, and I tell this story in all respect.

But he said that the farmers most of them in their time told him that they were sort of like the rat that had gotten in the trap. The trap was on their neck, and the rat made the comment that he didn't want to eat any more cheese, he just wanted to get his head out of the trap.

That sort of seems like it's now the position that the land bank itself is in. But it does remind me in going through these hearings here today.

I have a couple of questions. First off, in going back to your statement about what might happen in the first of these alternatives if we do nothing, no financial assistance.

Can you be a little bit more specific as to what would occur to the stock owned by farmers who are clients, customers, of the land bank at this time?

Mr. WILKINSON. Yes; one of the things that we would have to begin recognizing is that there are now land bank associations and there certainly are some 35 or more production credit associations that literally are insolvent. They are being kept in the financial process because of funding from their own banks, the FICB's in the case of the PCA's, and the land banks themselves. That can go on only for so long. And when that time and that funding is exhausted, then they have to look to the rest of the system for assistance, as has been done in Omaha with the FICB, and in Spokane.

The system itself now is beginning to reach a stage where it has evidenced to us and to the total system that certain districts are no longer, in their estimation, able to continue this process.

This could mean, Mr. Thomas, the continued liquidation or renewal of liquidations of production credit associations, Federal land bank associations, and then the banks themselves.

Now, when that happens, there could be the recognition that the class B stock is no longer viable, and it is at risk.

Mr. THOMAS. To get to my point here—and these 5 minutes go in a hurry—out of the $74 to $75 billion in outstanding loans made available to farmers, what portion of that would be stock in dollars and cents that the farmers would own?

Mr. WILKINSON. Mr. Edwards made reference earlier, and would you repeat the——

Mr. THOMAS. Sorry I missed that point.

Mr. EDWARDS. The stock investment the farmers own, at the bank level, farmers own about $5 billion in stock.

Mr. THOMAS. OK. All right. Let me ask you a couple of little more specific questions. We get pretty parochial here. Has it not been the policy in the past of the land bank when you worked out a foreclosure, you foreclosed on a farmer, and you assumed the land? Of course, we know that in the case of deficiency judgments, if you are not able to sell that land at what you think it's worth, you can go back to a deficiency judgment.

How prevalent a practice has it been in going back and pushing for deficiency judgments in the case of foreclosures in the past?

Mr. EDWARDS. It's very prevalent, Mr. Thomas.

Mr. THOMAS. Throughout the past 5 to 10 years, you've been doing this?

Mr. EDWARDS. Yes, sir.

Mr. THOMAS. That's not what I am told.

Mr. EDWARDS. So far as I know, throughout the life of the land bank. If there was——

Mr. THOMAS. All right. If you could, give me an idea of how many deficiency payments you've pushed for in the past year compared to last year? Can you do that?

Mr. EDWARDS. I have no idea. We don't keep those records, and I am not sure the banks do.

Mr. THOMAS. I would like to have those records, because this is part of your PR problem that many of us have alluded to here today, is we are being told now that this is becoming rampant throughout the system, that in my part of the area where you are going back and pushing for deficiency judgments.

Now, I am not saying you don't have a legitimate right here to do so, and we all understand that. But my point is you are pouring water on a drowned man to go back to these farmers that you foreclose on and try to do that.

Now, let me push on to get to one or two other questions. How many total acres of land does the land bank now have on its book across the United States, the whole Farm Credit System?

Mr. WILKINSON. Mr. Edwards.

Mr. EDWARDS. I don't know how many acres it has, but it's got about $675 million in acquired property.

Mr. THOMAS. $675 million. But you couldn't hazard a guess on what that would be in acres?

Mr. EDWARDS. No.

Mr. THOMAS. Could you tell me the area of most concentration of land that you own, and what part of the country it would be in? Is it the Southeast?

Mr. EDWARDS. No; I would think not.

Mr. THOMAS. I think Columbia has over 100,000 acres of land on its books in that system. Is that correct? Do any of you know that figure?

Mr. EDWARDS. I can get the figure. I don't know how many acres. I can get the dollar amount.

Mr. THOMAS. Well, let me close; again, I have a yellow light.

But the point I have been trying to drive at is that we all know that at this time that you certainly have got to take whatever steps you can to get the books of the land bank in as good a shape as possible and you're working through some areas that we've all talked about here this morning. And I understand that. I know it's a matter of reality.

But I want to stress to you that every time another piece of land is put on the market where there is no market already—let's face it—you can talk about a soft bottom to land—it's not a soft bottom. There is no bottom. Nobody knows what land is worth. There is no realistic price.

Until that somewhere firms up, we're going to all be dealing with the same concern that I have, and that is that even if we do something right now with another round of lower farm income and another round of a year with sliding land values, that we will be right back here in this same room again.

So, my point is that I for one am going to be watching to see what your action is in the interim as to whether we do something now in the next 2 months or in the next year to see what the land banks' action is going to be in helping us work through what is a very bad situation that we are all stuck in together.

I just don't see a further rash of foreclosures and land being put on the market and land being sold to nonstockholder clients of the land bank without the requirement of buying stock on conditions that you don't provide for member borrowers—these kinds of things are going to do nothing but exacerbate the very bad image that many people out there, whether it's correct or not, and we will hopefully get to the bottom of that in these hearings.

But it's a concern that I have, and I think you need to know it.

Mr. **Edwards**. Mr. Thomas, might I respond to that a moment, please? Sir, we share your concern about the image of the system. You cannot foreclose in a community and retain a good image.

The institution has an obligation, however, to pursue delinquent debts on the basis of good business practices. When they don't, the other farmers in that association pay the bill.

Mr. **Thomas**. Mr. Edwards, I think your comment is right on. But if the chairman will indulge me for just 1 second, I want to——

Mr. **Jones** of Tennessee. The time of the gentleman has expired. He will just have to wait for the next man to be heard, and then we will come back to him.

Mr. **Thomas**. Thank you, Mr. Chairman.

Mr. **Jones** of Tennessee. Mr. Evans, you are recognized for 5 minutes.

Mr. **Evans** of Iowa. Thank you, Mr. Chairman.

To carry on a bit about this subject of confidence in the associations and their handling of customers, I think the confidence is greatly eroded.

My question to you is, Do you see any possible role in the future of commercial banks handling at least part of the retailing function for the Farm Credit System that is now handled by the PCA's and land bank associations?

Mr. **Wilkinson**. Yes; there may very well be, Mr. Evans. One of the opportunities that you granted to the system as well as to the commercial banking industry in the 1980 amendments—and many of you were deeply involved in that—was some expansion of the opportunity for commercial banks, through the other OFI's—other financial institution programs—to participate.

We were, frankly, as FCA, somewhat surprised that there was not greater utilization of that new authority. But as we looked at it at that time, the banks were not in need for the funding from the system. They had other less costly sources.

I think that if we find some difficulties in certain institutions within the system, being able to serve, we as a regulator have a responsibility to look to other avenues of service.

Mr. **Evans** of Iowa. But the point of importance to me is that you are not philosophically opposed to going that route?

Mr. **Wilkinson**. No, sir. No, sir.

Mr. **Evans** of Iowa. Good. In the remaining time I would like to explore a bit further just how the funding corporation would operate relative to a specific case.

Let's assume that there is a borrower out there that owes a land bank association $100,000. Let's assume it's a nonperforming loan, that the collateral and the cash-flow is maybe adequate to treat $90,000, but something has to be done.

Under your management approach, what happens to that case?

Mr. WILKINSON. You are referring to the Capital Corporation at this point?

Mr. EVANS of Iowa. Well, yes, and the whole thing.

Mr. WILKINSON. Yes.

Mr. EVANS of Iowa. For example, under your new approach——

Mr. WILKINSON. That's right.

Mr. EVANS of Iowa. Could the land bank association foreclose, or would it foreclose, or would it transfer it to the Capital Corporation? Just what series of events——

Mr. WILKINSON. The sequence——

Mr. EVANS of Iowa [continuing]. Do you think might occur in that kind of a situation?

Mr. WILKINSON. Mr. Edwards, please.

Mr. EDWARDS. Mr. Evans, it might do any one or none of the items you cited.

Mr. WILKINSON. Yes.

Mr. EDWARDS. The lender, whether that's the Capital Corporation, a commercial bank, or a PCA——

Mr. EVANS of Iowa. Let's say it starts in the land bank association.

Mr. EDWARDS. Their interest is in collecting that loan with the least cost possible. If that means restructuring it, that's what occurs. Whether the loan is in a land bank or in the Capital Corporation on that issue doesn't matter.

Mr. EVANS of Iowa. You have no philosophical objection to restructuring a loan?

Mr. EDWARDS. Absolutely none. In many cases, that's the best way for the lender to get out of the loan.

Mr. EVANS of Iowa. What limits would you put on your definition of restructuring? Any?

Mr. EDWARDS. Only what good business judgment should dictate should be done.

Mr. EVANS of Iowa. You know that isn't being followed out there at this point?

Mr. EDWARDS. I suspect that that may be the case in some instances.

Mr. EVANS of Iowa. If it were going to go to the Capital Corporation, what would transpire?

Mr. EDWARDS. OK.

Mr. EVANS of Iowa. Who would get paid by whom, and what would be the ultimate disposition of the property and the lender and all that?

Mr. EDWARDS. In our proposal?

Mr. EVANS of Iowa. Yes.

Mr. EDWARDS. With a loan transferred from the land bank to the Capital Corporation, it's transferred at its collectible value. It's not transferred at an inflated value.

Mr. EVANS of Iowa. Not at the book value, but at reasonable collateral value?

Mr. EDWARDS. Reasonable collateral value. When the Capital Corporation has it on its books.

Mr. EVANS of Iowa. Would the association be paid in cash for the collateral value?

Mr. EDWARDS. That's correct.

Mr. Evans of Iowa. Yes; OK.

Mr. Edwards. Once the loan is on the books of the Capital Corporation, it might contract back with local banks or associations to manage that property on its behalf. That may mean managing it as an acquired property.

It may mean assisting in the restructuring of that debt and leave the farmer that owed the money on the farm———

Mr. Evans of Iowa. But that capital———

Mr. Edwards [interrupting]. In each case———

Mr. Evans of Iowa [continuing]. Corporation itself would not probably do the management; it would not attempt to manage all of these assets?

Mr. Edwards. We would not envision the Capital Corporation building a large enough staff to physically manage assets by itself. It would build a staff that would be in position to supervise that process and to assist local associations when workout expertise is required.

To build a staff large enough to physically manage the assets itself, you're talking about a very large corporation.

Mr. Evans of Iowa. Would the association take the loss at that time on the write-down from its book value to collateral value?

Mr. Edwards. When it sells the loan.

Mr. Wilkinson. Yes.

Mr. Evans of Iowa. Thank you, Mr. Chairman.

Mr. Jones of Tennessee. Thank you very much, Mr. Evans.

While we are on the subject of the farm credit Capital Corporation, I think, Governor, that it might be expeditious and helpful to the subcommittee if you would see to it that the bylaws of the Capital Corporation are submitted here for the record.

Mr. Wilkinson. Yes.

Mr. Jones of Tennessee. I think there might be a time when we might need those. You have no objection to that, do you?

Mr. Wilkinson. No, sir. That's a good idea.

[Information follows:]

ARTICLES OF INCORPORATION

OF

FARM CREDIT SYSTEM CAPITAL CORPORATION

We the undersigned incorporators, being all of the banks of the Farm Credit System (the "System"), acting upon the authority granted by resolutions of our respective boards of directors, do hereby adopt the following Articles of Incorporation for the purpose of forming a corporation under the provisions of Title IV, Part D, of the Farm Credit Act of 1971, as amended (such Act, as presently in effect and as hereafter amended is referred to herein as the "Act").

ARTICLE I

Name

The name of the Corporation shall be "Farm Credit System Capital Corporation" (the "Corporation").

ARTICLE II

Duration and Office

Section 1. Duration. The corporate existence of the Corporation shall commence on the approval of these Articles of Incorporation and the issuance of a charter by the Governor of the Farm Credit Administration (the "Governor") and shall continue in perpetuity until dissolved in accordance with these Articles and the Act.

Section 2. Principal Office. The principal office of the Corporation shall be located in the greater St. Louis metropolitan area in the State of Missouri. The Corporation may have such other offices as may be designated by its board of directors (the "Board").

ARTICLE III

Statutory Authority

The Corporation is established pursuant to Section 4.25 of the Act as an institution of the System and an instrumentality of the United States and shall be subject to the same supervision and examination by the Farm Credit Administration as are the Federal Land Banks, Federal Intermediate Credit Banks, and Banks for Cooperatives (one or more of which banks are hereinafter referred to as the "Banks").

ARTICLE IV

Purposes and Powers

Section 1. Purposes. The Corporation is formed for the purpose of performing activities authorized under these Articles and such functions and services on behalf and for the benefit of the Banks as are from time to time agreed to by the Corporation and the Banks and permitted by the Act, including, without limitation:

a. the purchase from the Banks or Production Credit Associations or Federal Land Bank Associations (one or more of which Associations are hereinafter referred to as the "Associations") of loans, or interests in loans, made, discounted, extended, participated in, purchased or otherwise acquired or held by one or more of the Banks or Associations under the authority of the Act (collectively "Loans"), and the purchase of other assets, real or personal, or interests in such assets, acquired by such Banks or Associations in connection with such Loans ("Acquired Property");

b. entering into participation or other agreements with the Banks, Associations or other institutions of the System with respect to such Loans and Acquired Property pursuant to which Loans or items or parcels of Acquired Property, or interests therein, are sold or otherwise conveyed to such Banks, Associations or other institutions of the System;

c. the servicing of such Loans and Acquired Property;

d. the provision of supervisory, managerial, technical and financially-related services to the Banks and Associations; and

e. the sharing of loan and other losses of the Banks, Associations and other institutions of the System.

Section 2. Powers. To achieve the purposes stated above, the Corporation shall have the following powers:

a. To engage in a general loan servicing business and to provide all services related thereto, including but not limited to actions and activities undertaken after a Loan has been made or extended in order to:

(i) keep informed as to a borrower's general activities and, where necessary, to monitor and encourage a borrower's financial and operating progress so as to reasonably assure the collectability of such loan and to the preservation of the collateral, if any, for loans;

(ii) to receive and collect any payments due with respect to loans;

(iii) to monitor loan document covenants for compliance;

(iv) to formally grant or withhold consent relative to proposed actions by a borrower when a loan document requires such consent;

(v) to obtain and analyze collateral reports, appraisal information, a borrower's federal, state, and local tax status, interim and annual financial statements, a borrower's insurance policies and bonds, reports of construction in progress, a borrower's commodity marketing position reports and aging of accounts receivable;

(vi) to prepare, maintain and periodically review collateral and security documentation for accuracy, appropriateness of filing and legal validity;

(vii) to attend meetings of a borrower's board of directors, if any;

(viii) to visit a borrower's place of business to inspect construction in progress, facilities, inventories, custodian or collateral records and procedures to generally maintain familiarity with management and operations; and

(ix) to exercise rights and remedies of the lender or secured party under related loan documents or applicable law.

b. To purchase or otherwise acquire secured or unsecured Loans, or interests in Loans from the Banks or Associations, at such times and on such terms as may be agreed to by the Corporation and the Banks or Associations;

c. To purchase, exchange, hold, own, improve, manage, operate, maintain, lease, sell, convey or mortgage, either alone or in conjunction with others, real estate of every kind, character and description whatsoever and wheresoever situated, and any interest therein;

d. To purchase, exchange, lease, own, manage, operate, maintain, mortgage, sell, either alone or in conjunction with others, personal property of every kind and character and description whatsoever and wherever situated, and any interest therein;

e. To render to the Banks or Associations, any supervisory, managerial, technical, financially-related or other services which from time to time may be agreed upon by the Corporation and such Banks or Associations;

f. To hold, service, sell, assign, transfer or otherwise convey or dispose of, to pledge, mortgage or otherwise encumber and to generally deal with Loans, Acquired Property and interests therein and any security therefor;

g. To acquire, possess and exercise any of the rights and privileges and assume and perform any of the duties and obligations of any of the Banks with respect to Loans, Acquired Property and interests therein or security therefor and to take such actions as are reasonably incident to such powers, including, without limitation:

(i) to adjust interest rates, compromise indebtedness, waive events of default, release collateral or amend Loan documents;

(ii) to make evaluations and recommendations to Banks or Associations as to the advancement by those institutions of funds to borrowers when necessary or appropriate to effectuate the collection of the Loans or the liquidation of Acquired Property or to preserve, conserve or protect the Loans or Acquired Property and to purchase such advancements from the advancing institution; and

(iii) to take any action, including the institution of legal proceedings, necessary or appropriate to collect the Loans or liquidate the Acquired Property.

h. To enter into any lawful arrangement with any individual or any cooperative association, corporation, association, general or limited partnership, trust, individual or other legal entity, including, but not limited to any of the Banks or Associations; and participate with any such individual or entity in any corporation, limited partnership, joint venture or other association of any kind, for any lawful purpose related to the purposes of the Corporation:

i. To enter into, make, perform, enforce, cancel or rescind any contracts, including but not limited to contracts of insurance, for any lawful purposes pertaining to the purposes of the Corporation;

j. To acquire, borrow, hold, deposit, invest and reinvest, apply, and dispose of any funds for the accomplishment of the purposes of the Corporation, provided, however, that the Corporation is not empowered to borrow from any person or entity other than the institutions of the System unless any such borrowing from any such person or entity is (i) made on a non-recourse basis, i.e., borrowing secured by specific collateral but not backed by the general credit of the Corporation, or (ii) guaranteed by one or more of the Banks with the approval of the Governor;

k. To elect, appoint and engage officers, agents and employees of the Corporation, and engage attorneys, accountants and other independent contractors to give advice and assistance to the Corporation generally or with respect to particular matters and define their duties and fix their compensation;

l. To indemnify any present or former director, officer, agent or employee of the Corporation against all liabilities and related expenses incurred by him in connection with, or arising out of any action, suit or proceeding in which he is made a party by reason of being or having been such director, officer, agent or employee except in relation to matters as to which he shall be adjudged in such action, suit or proceeding to be liable for gross negligence or willful misconduct in the performance of his official duties.

m. To provide for the operation of the Corporation and the conduct of its activities through bylaws, not inconsistent with the law or these Articles, adopted by the Board with the approval of the Governor (the "Bylaws");

n. To issue and retire capital stock of the Corporation as permitted by these Articles and the Bylaws;

o. To retain or distribute earnings of the Corporation in accordance with these Articles and the Bylaws;

p. To pay patronage refunds in accordance with the Bylaws;

q. To pay any sum necessary or advisable to preserve, conserve, protect, rehabilitate or improve any assets or property on which the Corporation has a lien or in which the Corporation has a financial or property interest and to pay off and discharge any liens, claims, or charges of any nature against such property;

r. To investigate any matter related to the conduct of the business of the Corporation, including, but not limited to, any claim of the Corporation against any individual or entity and institute appropriate legal or other proceedings in the name of the Corporation to prosecute such claim;

s. To institute, prosecute, maintain, defend, intervene, and otherwise participate in the name of the Corporation in any legal proceedings by or against the Corporation or in which the Corporation has any interest, and to represent in every way the Corporation;

t. To execute, acknowledge, and deliver through its officers, any instrument necessary for any authorized purpose;

u. To release any assets or property of any nature, regardless of whether the subject of pending litigation;

v. To settle, release or obtain release of for cash or other consideration, claims and demands against or in favor of the Corporation, including, without limitation, claims against obligors of the Loans;

w. To pay out of the assets of the Corporation all expenses and all costs of carrying out or exercising the rights, powers, privileges, and duties of the Corporation;

x. To exercise all authorities and powers of the Banks under the Act consistent with the purposes of the Corporation;

y. To take all actions and have such rights, powers and privileges as are necessary and incident to the exercise of any specific powers;

z. To take such actions and have such additional rights, powers, privileges, immunities and duties as the Farm Credit Administration authorizes, directs, confers or imposes by order or by amendment of an order or by regulation.

Section 3. Limitations. The exercise by the Corporation of the powers conferred by these Articles is subject to the provisions of the Act, and the Corporation shall not have the authority to extend credit or provide insurance services for borrowers from System institutions, nor any greater authority with respect to functions or services than the Banks possess under the Act.

ARTICLE V

Shareholders and Capitalization

Section 1. Qualifications and Liability of Shareholders. The shareholders of the Corporation shall consist solely of such of the Banks as from time to time shall hold one or more shares of the capital stock of the Corporation. The liability of each shareholder for debts and obligations of the Corporation by reason of its status as a shareholder shall be limited to the subscription price of the shares of the capital stock of the Corporation purchased by such shareholder and no shareholder, by reason of its status as such, shall be responsible for the claims of creditors of the Corporation.

Section 2. Capital Stock. The Corporation shall be authorized to issue capital stock having a par value of One Hundred Dollars ($100.00) per share (the "Stock") which shall be issued and sold at par value, to such of the Banks as from time to time may subscribe for and purchase shares of such Stock.

a. Each holder of one or more shares of Stock shall be entitled to one vote per share on all matters requiring a vote by shareholders of the Corporation.

b. The Board may declare, from surplus made available therefor, dividends payable to holders of Stock at such times, in such amounts and subject to such qualifications or conditions as may be determined by the Board; provided, however, that any dividends declared on the Stock shall be payable ratably on each share outstanding.

c. Upon the dissolution and liquidation of the Corporation, all assets of the Corporation shall be applied and distributed as follows and in the following order of priority, subject to the approval of the Farm Credit Administration:

(i) to the payment of the debts and liabilities of the Corporation (including amounts which may be owed to any shareholder which is a creditor of the Corporation), according to their respective priorities, and to the payment of expenses of liquidation;

(ii) to the holders of outstanding shares of the Stock on a pro rata basis. Liquidation distributions to shareholders may be made in cash or in kind, as determined by the Governor.

d. Shares of the Stock may be evidenced by certificates or, at the option of the Board, by appropriate entry on the Corporation's books and ownership thereof shall be confirmed by the Corporation upon the request of the holder.

e. Only Banks may own or hold shares of the Stock.

f. Stock may be transferred only upon the approval of and subject to such conditions as may be established by the Board. Shares of Stock shall not be subject to redemption or retirement by the Corporation without the consent of the holder.

g. The notice and quorum requirements for meetings of shareholders and the vote required for shareholder action shall be as provided for in these Articles or in the Bylaws.

Section 3. Initial Capitalization. As soon as practicable after the issuance by the Governor of a charter for the Corporation, each of the Banks shall subscribe for and purchase at par value, 750 shares of the Stock.

ARTICLE VI

Board of Directors

Section 1. Authority. Subject to the limitations expressed in these Articles and applicable law, the entire business and affairs of the Corporation shall be directed by the Board.

Section 2. Membership. The Board shall consist of the members of the Farm Credit System Finance Subcommittee as such Subcommittee shall be constituted from time to time.

Section 3. Bylaw Provisions. The authority of the Board to act through committees and the notice, quorum and vote required for action by the Board shall be as provided in the Bylaws.

ARTICLE VII

Merger and Dissolution

Section 1. The Corporation may be merged or consolidated with any other entity upon the affirmative vote of eighty percent (80%) of the Stock outstanding and the approval of the Governor.

Section 2. This Corporation shall be dissolved and liquidated upon the affirmative vote of eighty percent (80%) of the Stock outstanding. Subject to the requirements of the Act and the regulations promulgated thereunder, the Governor or his designee shall act as receiver and trustee for the accomplishment of the dissolution and liquidation of the Corporation in accordance with these Articles.

ARTICLE VIII

Amendments

These Articles of Incorporation may from time to time be amended by the affirmative vote of eighty percent of the Stock outstanding, provided that no such amendment shall be effective until it has been approved by the Governor.

(Attachment follows:)

EXHIBIT "B"

5/10/85

BYLAWS

OF

FARM CREDIT SYSTEM CAPITAL CORPORATION

ARTICLE I

Definitions

1. Act. The term "the Act" shall refer to the Farm Credit Act of 1971, as amended.

2. Banks. The term "Banks" shall refer to one or more of the Federal Land Banks, the Federal Intermediate Credit Banks, and the Banks for Cooperatives, all as chartered and existing under Titles I, II, and III of the Act, respectively.

3. Board. The term "Board" shall refer to the Board of Directors of the Corporation.

4. Chairman. The term "Chairman" shall refer to the Chairman of the Board of the Corporation.

5. Corporation. The term "Corporation" shall refer to the Farm Credit System Service Corporation.

6. Finance Committees. The term "Finance Committees" shall refer to the Finance Committees provided for in Section 4.5 of the Act.

7. Finance Subcommittee. The term "Finance Subcommittee" shall refer to the Farm Credit System Finance Subcommittee authorized under Section 4.5 of the Act.

8. Governor. The term "Governor" shall refer to the Governor of the Farm Credit Administration.

9. Participating Banks. The term "Participating Banks" shall refer to those Banks that have entered into a participation agreement or agreements with the Corporation.

ARTICLE II

Shareholder Meetings

1. Annual Meetings. There shall be an annual meeting of the shareholders each year at the time and at the place designated by the Board, at which meeting the Board shall report on the activities and financial condition of the Corporation.

2. Special Meetings. Special meetings of the shareholders may be called by the Chairman and shall be called by the Chairman at the request in writing of a majority of the entire membership of the Board or at the written request of twenty percent (20%) of the shareholders.

3. Notice of Meetings.

   a. At the direction of the Chairman, the President or his designee shall cause written notice of each shareholder meeting to be mailed at least thirty (30) days prior to the meeting to each shareholder at the address of such shareholder as the same appears on the records of the Corporation.

   b. The written notice of each annual or special meeting shall specify the time and place of the meeting and contain a brief statement of the business to be conducted.

4. Quorum. A majority of all the shareholders, when present by their duly authorized representatives, shall be requisite to and shall constitute a quorum at all meetings of the shareholders. In the absence of a quorum at any such meeting, a majority of the shareholders represented may adjourn the meeting from time to time, not to exceed sixty (60) days at any one adjournment, without further notice until a quorum shall be presented or represented.

5. Organization of Meeting. The Chairman or any officer of the Corporation shall call meetings of the shareholders to order and act as chairman of such meetings. In the absence of said Chairman and officers, the authorized representative of any shareholder entitled to vote thereat may call the meeting to order and a chairman shall be elected by a majority of the shareholders represented thereat.

6. Minutes of Meetings. The Secretary of the Corporation shall act as recording secretary of all meetings of shareholders, unless some other person is designated by the chairman of the meeting to serve in that capacity. Copies of minutes of shareholder meetings shall be promptly forwarded to the shareholders and to the Farm Credit Administration.

7. The Voting.

   a. On any question properly before the shareholders, each shareholder shall be entitled to cast one vote per share of the capital stock of the Corporation owned by such shareholder.

b. Each shareholder shall, by resolution of its Board, designate its duly authorized representative and an alternate to vote or act in his/her absence on any question properly before a meeting of the shareholders; provided a certified copy of such resolution shall have been delivered to the secretary of the meeting.

c. When a quorum is present at any meeting of shareholders, the vote of a majority of the shareholders represented thereat shall decide any question brought before such meeting, unless the question is one upon which by express provision of the Articles of Incorporation or these Bylaws a different vote is required, in which case such express provision shall govern and control the decision on such question.

ARTICLE III

Board of Directors

1. Responsibilities. The Board shall have responsibility to direct the business and affairs of the Corporation and to prosecute its policies and the purposes for which it is established and in so doing to:

a. Maintain policy overview of the organization, administration, managerial and personnel structure of the corporation and the adequacy of its controls;

b. Approve the Corporation's major operating policies and its objectives, plans, programs, and budgets;

c. Review the operations of the Corporation on a periodic basis to judge the effectiveness of all its functions and activities in relation to established policies and objectives;

d. Monitor the appropriateness of relationships and communications between the Corporation, the presidents and boards of directors of the Banks, and the Farm Credit Administration;

e. Employ and fix the compensation of the President and evaluate the performance of the President in all areas of responsibility.

2. Composition and Term. The composition of the Board shall be as required in the Articles of Incorporation.

3. Officers of the Board.

   a. The Chairman of the Finance Subcommittee shall serve as Chairman of the Board. The Chairman shall preside at all meetings of the Board, shall coordinate and direct the activities of the Board, and shall perform such other duties as provided in the Bylaws or as the Board may from time to time determine. A Vice Chairman shall also be elected from among the directors and shall exercise the functions of the Chairman during the Chairman's absence or disability. The Vice Chairman shall have such other duties as assigned to him or her from time to time by the Board.

   b. The Vice Chairman shall be elected by the Board for a term of one year. The election of the Vice Chairman shall be held at the annual meeting of the Board.

   c. The Vice Chairman may be removed from office by the Board whenever, in its judgment, the best interests of the Corporation would be served thereby.

   d. Any vacancy in the office of Vice Chairman by reason of death, resignation, or otherwise shall be filled by the Board at their next meeting for the unexpired portion of the term.

   e. The Secretary of the Corporation shall serve as Secretary to the Board.

6. Meetings. The Board shall hold four (4) regular quarterly meetings each year, one of which meetings shall be the annual meeting of the Board. The Board may hold such other meetings as may be determined necessary or appropriate to the discharge of its duties and functions and the proper operations of the Corporation. Meetings of the Board shall be held at such time or times and at such place as may be determined by the Board and specified in the notice of such meeting. Members of the Board may participate in a meeting of the Board by means of conference telephone or similar communications equipment by which all persons participating in the meeting can hear each other at the same time. Such participation shall constitute presence in person at the meeting.

7. Notice of Meetings. Notice of each meeting of the Board shall be given to each director. If such notice is given either by personally delivering written notice to a director or by personally telephoning such director, it shall be so given at least five (5) days prior to the meeting. If such notice is given either by depositing a written notice in the United States mail, postage prepaid, or by transmitting a cable telegram, in all cases directed to such director at his

place of business, it shall be so given at least ten (10) days prior to the meeting. The notice of all meetings shall state the place, date, and hour thereof, and shall briefly state the purpose or purposes thereof.

8. Quorum. No less than two-thirds of the directors provided for in the Articles of Incorporation shall constitute a quorum for the transaction of business at any meeting of the Board, but less than a quorum may adjourn from time to time until a quorum is in attendance. Whenever a quorum is in attendance, a vote of the majority of the directors present shall determine the decision of the Board, unless otherwise provided in these Bylaws.

9. Minutes of Meetings. The Board shall ensure that full and accurate minutes of its meetings are kept and that copies of such minutes are promptly forwarded to the shareholders and to the Farm Credit Administration.

ARTICLE IV

Committees

1. Committees of Directors. The Board, by resolution adopted by a majority of the directors in office, may designate one or more committees, each of which shall consist of two or more directors, which committees, to the extent provided in said resolution and not restricted by law, shall have and exercise the authority of the Board in the direction of the Corporation; but the designation of such committees and the delegation of authority thereto shall not operate to relieve the Board, or any individual director, or any responsibility imposed by law.

2. Other Committees. Other committees not having nor exercising the authority of the Board in the direction of the Corporation may be designated by a resolution adopted by a majority of the directors present at a meeting at which a quorum is present. The members of such committees may include individuals who are not directors. Such resolution may delegate to the Chairman authority to appoint the members of such committees.

3. Vacancies/Removal. Any committee member may be removed and vacancies may be filled by the person or persons authorized to appoint members of that committee.

ARTICLE V

Waiver of Notice and Action Without a Meeting

1. Waiver of Notice. Whenever any notice is required to be given under the provisions of the Articles of Incorporation or these Bylaws, a waiver thereof in writing signed by the person(s) entitled to such notice, whether before or after the time at which such notice is required or the time of the meeting to which such notice would have pertained, or the appearance of such person(s) at such meeting (except for the sole purpose of challenging the propriety of the meeting) shall be deemed equivalent to the giving of such notice.

2. Action Without a Meeting. Any action which may be taken at a meeting of the shareholders of the Corporation, the Board, or any committee may be taken without a meeting if a consent in writing, setting forth the actions so taken, shall be signed by all the shareholders, directors, or members of such committee, as the case may be, entitled to vote with respect to the subject matter thereof.

ARTICLE VI

Officers

1. Election and Tenure. The officers of the Corporation shall consist of a President, a Secretary, and a Treasurer, and any such other officers as the Board may deem necessary. The President shall be elected by and shall serve at the pleasure of the Board of Directors. All other officers of the Corporation shall be appointed by and serve at the pleasure of the President. The President may delegate to any other officer the power to appoint or remove subordinate officers, agents, or employees of the Corporation. Any two or more offices may be held by the same person, except no person shall serve simultaneously as President and Secretary. Each officer so elected or appointed shall continue in office until his or her successor shall be elected or appointed and shall qualify, or until his or her earlier death, resignation, or removal.

2. President. The President shall be the chief executive officer of the Corporation and shall manage its affairs under the direction of the Board. The President shall see that all orders and resolutions of the Board are carried into effect and shall perform all duties as may from time to time be assigned to him or her by the Board. The President shall have general and active management of the business of the Corporation.

3. Secretary. The Secretary shall perform such duties and shall have such powers as may from time to time be assigned by the President. In addition, the Secretary shall perform such duties and shall have such powers as are incident to the office of Secretary, including, without limitation, the power to give notice of all meetings of shareholders and the Board, to attend such meetings and keep a record of proceedings, and to be custodian of corporate records and the corporate seal and to affix and to attest to the same on documents, the execution of which on behalf of the Corporation is authorized by these Bylaws or by the action of the Board.

4. Treasurer. The Treasurer shall perform such duties and shall have such powers as may from time to time be assigned by the President. In the absence of the President or in the event of his inability to act, the Treasurer shall perform the duties of the President and when so performing shall have all the powers of and be subject to all the restrictions upon the President. In addition, the Treasurer shall perform such duties and have such powers as are incident to the office of Treasurer, including without limitation the duty and power to keep and be responsible for all funds and securities of the Corporation, to deposit funds of the Corporation in a depository selected in accordance with these Bylaws, to disburse such funds as ordered by the Board making proper accounts thereof, and to render as required by the Board statements of all such transactions as Treasurer and of the financial condition of the Corporation.

ARTICLE VII

Indemnification of Directors, Officers, and Employees

The Corporation shall indemnify each director, officer, and employee of the Corporation (and his heirs, executors, and administrators) against all liabilities and related expenses incurred by him in connection with or arising out of any action, suit, or proceeding brought against him by reason of any act or omission in the performance of his official duties as a director, officer, or employee of the Corporation (whether or not he continues to be a director, officer, or employee at the time of incurring such expenses or liabilities). Such expenses and liabilities shall include, but not be limited to, court costs and attorneys fees, judgments, and costs of reasonable settlement. The Corporation shall not, however, indemnify any director, officer, or employee for expenses and liabilities arising from such person's gross negligence or willful misconduct in the performance of official duties. With respect to officers and employees, the prohibition against indemnification shall apply only when the finding of gross negligence or willful misconduct is made by a court at final adjudication or, if the matter is settled out of court, by the Board. With respect to directors, the prohibition against indemnification shall apply only when such finding is made by a court at final adjudication. The foregoing right of indemnification shall not be exclusive of other rights to which any director, officer, or employee may be entitled as a matter of law. Further, the foregoing right to indemnification shall include indemnification for claims arising out of any director's, officer's or employee's serving as a director, officer, trustee or performing work on behalf of any industry related organization or non-profit organization when such person is so authorized by the Corporation's board of directors, its president or his delegate.

ARTICLE VIII

Stock Certificates

The Corporation may issue a stock certificate to each shareholder, which certificate shall be signed by the President and the Secretary and in such form as the Board shall prescribe. In the alternative, stock ownership may be evidenced by appropriate entry on the records of the Corporation.

ARTICLE IX

Application and Distribution of Earnings

1. Accumulated Earnings and Dividends. Subject to the requirements of Section 2 of this Article, earnings of the Corporation shall, in the discretion of the Board, be accumulated or distributed as dividends on capital stock, provided that the amount so distributed with respect to any fiscal year of the Corporation shall not exceed that amount which when multiplied by a fraction the numerator of which is "net margins" defined in Section 2, and the denominator of which is all net earnings, including such net margins, equals $250,000.

2. Patronage Refunds. All earnings of the Corporation attributable to fees payable to it by Participating Banks as compensation for services rendered by it to or on behalf of the Participating Banks during the fiscal year of the Service Corporation, less costs and operating expenses attributable thereto, shall be referred to herein as "net margin." The Corporation shall be obligated as soon as practicable after the close of each fiscal year and in no event later than 8-1/2 months after such close, to pay to each Participating Bank in cash as a patronage refund its pro rata share of all net margin for the year in excess of $250,000. Each Participating Bank's pro rata share shall be determined by multiplying the aggregate patronage refund by a fraction the numerator of which is such fees payable to the Service Corporation by that Bank with respect to the fiscal year, and the denominator of which is the aggregate of all such fees payable by the Participating Banks with respect to such year.

ARTICLE X

Dissolution and Liquidation

Upon dissolution, after all known debts and liabilities of the Corporation have been paid, and all reserves for payment of contingent or unforeseen liabilities or obligations have been established as required by the Governor and all patronage refunds required by Section 2 of Article IX have been paid, the remaining property and assets of the Corporation shall be distributed among the shareholders in proportion to their respective stock ownership as reflected on the books of the Corporation.

ARTICLE XI

Execution of Instruments; Loans; Checks and Endorsements; and Deposits

1. Execution of Instruments. The President or Treasurer shall have the power to execute and deliver on behalf of and in the name of the Corporation any instrument requiring the signature of an officer of the Corporation, except as otherwise provided in these Bylaws or where the execution and delivery thereof shall be expressly delegated by the Board to some other officer or agent of the Corporation. Unless authorized so to do by these Bylaws, the Board, or the President, no officer, agent, or employee shall have any power or authority to bind the Corporation in any way, to pledge its credit, or to render it liable pecuniarily for any purpose or in any amount.

2. Borrowing. No loan shall be contracted on behalf of the Corporation, and no evidence of indebtedness shall be issued, endorsed, or accepted in its name, unless authorized by the Board or a committee designated by the Board to so act. Such authority may be general or confined to specific instances. When so authorized, the officer or officers thereunto authorized may effect loans at any time for the Corporation from any bank or other entity and, in connection with such loans, may execute and deliver promissory notes or other evidences of indebtedness of the Corporation, and when authorized as aforesaid, as security for the payment of any and all loans (and any obligation incident thereto) of the Corporation, may mortgage, pledge, or otherwise encumber any real or personal property, or any interest therein, at any time owned or held by the Corporation, and to that end may execute and deliver such instruments as may be necessary or proper under the circumstances; provided however, that the Corporation is not empowered to borrow from any person or entity other than the institutions of the System unless any such borrowing from any such person or entity is (i) made on a non-recourse basis, i.e., borrowing secured by specific collateral but not backed

by the general credit of the Corporation, or (ii) guaranteed by one or more of the Banks with the approval of the Governor.

3. Checks and Endorsements. All checks, drafts, or other orders for the payment of money, obligations, notes, or other evidences of indebtedness, and other such instruments shall be signed or endorsed by such officers or agents of the Corporation as shall from time to time be determined by resolution of the Board, which resolution may provide for the use of facsimile signatures.

4. Deposits. All funds of the Corporation not otherwise employed shall be deposited from time to time to the Corporation's credit in such banks or other depositories as shall from time to time be determined by resolution of the Board and as permitted by the Act and regulations of the Farm Credit Administration. Such resolution may specify the officers or agents of the Corporation who shall have the power, and the manner in which such power shall be exercised, to make such deposit and to endorse, sign, and deliver for collection and deposit checks, drafts, and other orders for the payment of money payable to the Corporation or its order.

ARTICLE XII

Corporate Seal

The corporate seal shall be in the form approved by resolution of the Board. Said seal may be used by causing it or a facsimile thereof to be impressed or affixed or in any other manner reproduced. The impression of the seal may be made and attested by either the Secretary or any Assistant Secretary for the authentication of contracts or other papers requiring the seal.

ARTICLE XIII

Fiscal Year

The fiscal year of the Corporation shall be the year established by the Board.

ARTICLE XIV

Amendments

These Bylaws may be altered, amended, or repealed and new Bylaws may be adopted by the affirmative vote of eighty percent (80%) of the stock outstanding at any regular or special meeting of shareholders with respect to which notice of intention to alter, amend, repeal, or adopt new Bylaws at such meeting has been given and which notice includes a copy of the proposed amendment. No such amendment shall be effective until approved by the Governor.

Mr. JONES of Tennessee. Mr. Weaver, did you have further questions?

Mr. WEAVER. A very quick question, Mr. Chairman.

Governor, what percentage of the Farm Credit System paper is owned by foreigners? And how much money does that represent?

Mr. WILKINSON. May I ask Mr. Duncan?

Mr. WEAVER. Please, by all means. Just so I have the facts.

Mr. DUNCAN. Disposition or the ownership of the Farm Credit System paper at the point that it leaves the dealer's hands is approximately as follows: About 50 percent of the paper is owned by lending institutions in the United States, including many, many of the agricultural banks across America's heartland.

Mr. WEAVER. They buy it as an investment?

Mr. DUNCAN. That is correct.

Mr. WEAVER. Right.

Mr. DUNCAN. Perhaps as much as 18 to 20 percent of the paper is owned by foreigners.

Mr. WEAVER. 20 percent?

Mr. DUNCAN. Foreign governments or foreign representatives.

Mr. WEAVER. That would represent $15 billion?

Mr. DUNCAN. Whatever that percentage would work out to, yes.

Mr. WEAVER. $15 billion owned by foreigners.

Thank you very much.

Mr. JONES of Tennessee. Thank you very much, Mr. Weaver.

I would recognize Mr. Coleman.

Mr. COLEMAN. Marvin, give us the rest of it. That's 70 percent of it. Where are the other 30 percent held?

Mr. DUNCAN. Another significant chunk of that would be owned by investment firms, pension plans, institutions—including State governments and so forth. And of course, individuals, individual investors hold part of that portfolio.

Mr. COLEMAN. OK.

Larry, I am confused with your previous answer to my question. Would you walk it through again?

Mr. EDWARDS. Sure.

Mr. COLEMAN. Earlier I asked you about your reserves and what you are ready to commit to this Capital Corporation, would you give me those figures again and what they represent?

Mr. EDWARDS. OK, the system has an earned net worth in the banks and associations of approximately $5.5 billion. It has reserves for losses of $1.6 billion.

Mr. COLEMAN. And how much of these figures represent stock ownership, if any, by farmers?

Mr. EDWARDS. Of those figures, none of it.

Mr. COLEMAN. All right. So you are not suggesting that farmer-held stock be committed as a part of your resources through this Capital Corporation; is that correct?

Mr. EDWARDS. As part of the system's resources, no.

Mr. COLEMAN. All right. And of what type of assets is your so-called net worth made up of?

Mr. EDWARDS. Net worth is not assets.

Mr. COLEMAN. All right.

Mr. EDWARDS. It represents the ownership residual in the business, and it's used to finance the entire asset structure. It's not a pile of cash that's sitting somewhere. It is funds that are available to absorb losses.

Mr. **Coleman**. They're not liquid?

Mr. **Edwards**. No.

Mr. **Coleman**. Explain to me what these are. I still don't understand what the $5.5 billion consists of.

Mr. **Edwards**. OK; the balance sheet of any individual or institution is composed of three things: assets, liabilities, and net worth. Capital stock is net worth that somebody purchased in the business.

Mr. **Coleman**. But we're not talking about that now.

Mr. **Edwards**. No; earned net worth would be the accumulation of earnings over the years the business has been in business.

Mr. **Coleman**. So these are accumulated earnings.

Mr. **Edwards**. Yes; for the 60-odd years the system has been in business.

Mr. **Coleman**. And in what form are these? Are these in some sort of instruments, or are they just on your books, or are they in buildings?

Mr. **Edwards**. They're in loans and buildings and automobiles, anything the institution owns.

Mr. **Coleman**. So, in fact, your assets that you are willing to commit to the Capital Corporation might consist of outstanding loans?

Mr. **Edwards**. No.

Mr. **Coleman**. No?

Mr. **Edwards**. No; you're taking me into technical accounting here. The net worth of the institutions, its earned net worth, represents its ability to absorb losses without impairing members' stock. It does not represent a pile of money that can be moved from here to here. It does represent the ability to absorb adversity.

Mr. **Coleman**. I would like to have some of that in my checking account. [Laughter.]

Mr. **Edwards**. You have some of it as your equity in your house. You can't move it anyplace. It represents your power to borrow and your ability to absorb adversity. You can't spend it.

Mr. **Coleman**. But I guess the point I am trying to get at is, if you transfer to a Capital Corporation, what are you transferring to them?

Mr. **Edwards**. The ability to absorb losses.

Mr. **Weaver**. Would the gentleman yield?

Mr. **Coleman**. The ability to absorb losses based upon what if there is a loss?

Mr. **Edwards**. I am not sure I understand the question, Mr. Coleman.

Mr. **Coleman**. Let's say there are losses. Who pays who?

Mr. **Edwards**. The system's resources. Its earned net worth would be used to absorb those losses, just like an individual institution's earned net worth is used to absorb losses today. The problem is that earned net worth in some institutions is exhausted, while the system still has considerable resources.

Mr. **Coleman**. But your earned net worth is not anything tangible you can show me. It's not anything on an accounting sheet.

Mr. **Edwards**. Yes.

Mr. COLEMAN. It is? But there's nothing out there to show its existence except for that?

Mr. EDWARDS. It's the difference between what you have in assets and what you owe in debts.

Mr. WEAVER. Would the gentleman yield?

Mr. COLEMAN. Well, that is your net worth, but it also can evaporate rather rapidly if you owned an oil well somewhere and oil prices decline. You can borrow a lot of money, like Mexico did, banking on that.

And you're shaking your head in a positive fashion. Is this real stuff we're talking about, or is this stuff you like to tell us you're going to contribute to this Capital Corporation?

Mr. EDWARDS. It's real ability to absorb losses.

Mr. COLEMAN. That's your opinion?

Mr. EDWARDS. That's correct.

Mr. COLEMAN. Is Price-Waterhouse & Co. going to so declare?

Mr. EDWARDS. Beg your pardon?

Mr. COLEMAN. Would Price-Waterhouse & Co. so declare in their audit?

Mr. EDWARDS. Will they?

Mr. COLEMAN. Would they?

Mr. EDWARDS. I can't say what Price-Waterhouse & Co. would declare.

Mr. COLEMAN. Well, let me just pursue——

Mr. WEAVER. I think the gentleman is on an extremely important line of questions.

Mr. COLEMAN. I will yield if I can get another minute or so.

Mr. JONES of Tennessee. Sure.

Mr. COLEMAN. I yield.

Mr. WEAVER. I am just simply saying that it depends on the evaluation of the paper—I mean, excuse me, of the loans. If those farm loans aren't worth what they say on the face value of the mortgage, they don't have any net worth, and so the gentleman has pierced this thing, I think, perfectly.

The likelihood is, if we really evaluated the loans now on the books of the Farm Credit Administration, we would find that they have no net worth. If they have cash, the only cash they're going to have is to go out and sell more paper and put cash in the bank, and that can be transferred, but that just makes the paper that much more shaky.

Mr. COLEMAN. Well, if I might take the minute?

Mr. JONES of Tennessee. The gentleman is recognized.

Mr. COLEMAN. What would be wrong, Mr. Wilkinson, with the suggestion that has been made in some circles that the bondholders take a 15 percent hit on the value of their security and absorb that loss in exchange for a 5-year Government guarantee of your securities that would be thereafter floated out on Wall Street?

Mr. WILKINSON. There are several things that we believe would be wrong with that. One is that it would truly undermine, in my estimation, the integrity of the Farm Credit System and its securities.

But it would not stop there, sir. It would undermine, I think, the similar securities of the other agencies. We're talking about FNMA and the Home Loan Bank Board. And if you'll look at it in the international circles, some of our foreign investors do not separate these agencies' securities, including farm credit's, from Treasuries. And we would be very fearful that it would have a significant international impact on the integrity of the financial community and the Government itself.

A second area that we would not want to overlook would be that it would be a major—it could cause a major disruption of the rest of the financial community or major parts thereof because, you heard Mr. Duncan share with you who owns these securities, 40 percent of the farm credit securities are held by commercial banks. This could cause a very significant impact in the rest of the commercial banking industry.

Mr. COLEMAN. But, Mr. Wilkinson, there is no Government guarantee of those bonds, and if I wanted to go out and buy bonds today that aren't guaranteed by the U.S. Government, I know that I could lose part of my principal investment. Why are we suddenly going to be all concerned about banks—who, if anybody ought to know in this country who guarantees what and they own half of your paper—why wouldn't the bankers of this Nation know they're not guaranteed? And we're not talking about ma-and-pa investors when we're talking about foreign investors, we're talking about huge sums of money.

No one has ever said these were guaranteed. No one should have assumed that they were guaranteed. And I think that it really gets to me when we go through all this process—when you're asking $5 billion, $10 billion, how many billions of dollars, I don't know, because somebody out there is going to be left hanging to dry, who walked into it on their own two feet—and yet we go round and round and round about this to help farmers.

We haven't seen this much interest in helping—$5 billion for farmers or anybody else—but when it comes to people who are in the field, who ought to know what they did when they did it, then, "We have to do something, and we have to do it within the next month."

Mr. WILKINSON. I think you want to remember, Mr. Coleman, the very farmers we're talking about, many of them who may not be burdened with debt, are actually holders of Farm Credit securities. They are investors.

Mr. COLEMAN. Well, Mr. Duncan said that 50 percent were held by lending institutions. Heaven forbid, we're depending on these people to give us all guidance. Twenty percent are held by outside interests, foreign corporations, individuals. I am not sure where they might come from.

So let's recognize that what you're asking us to do is basically buy a life insurance policy for somebody who has died. [Laughter.]

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Coleman.

Are there any other members who would like to ask questions? Mr. Stenholm.

Mr. STENHOLM. Mr. Chairman, no questions, but I would like to add that the previous line of questioning disturbs me greatly, because as a borrower, which I am as a farmer, if the attitude displayed by the gentleman from Missouri is the prevalent attitude, the cost to those farmers that so many of us on this subcommittee have a sincere interest in is going to skyrocket.

My interest rate, my costs on my farm, is going to go up dramatically were we to take the attitude that has just been prevalent. And I hope that as we get further into this, that we will recognize we're not talking about a bailout of anything other than the system that provides credit available to farmers now in a time of dire need.

And I hope, Mr. Coleman, that you will reflect on the answer of Mr. Wilkinson, Mr. Duncan, and others a little bit further before we say there is nothing in this for farmers. We have $200 billion borrowed. Every time interest rates go up 1 percent, the cost to the individual farmer goes up tremendously. What we're talking about is a system and not bailing out anybody.

But I want to assure you that, as a farmer, I have a vested interest in seeing that we regain the confidence and why I am very happy to see in this morning's Wall Street Journal an indication by this administration that they are not going to take a hands-off attitude with the Farm Credit System in this country.

Mr. COLEMAN. Would the gentleman yield?

Mr. STENHOLM. I would be happy to yield.

Mr. COLEMAN. The point I am trying to make is that the Governor has said that alternative one, which is no action, would be terrible. We have been getting alternative one for the last year, and that's terrible. Now they're coming in and asking us to ramrod something through without a whole lot of time to think, or to acknowledge the existence of, and how deep the problem is when they've already slashed it in half from $10 billion to $5 billion of their revolving fund.

All I am saying is, if you think alternative one was bad, Governor, basically, that's what you've given us for the last year is alternative one—no action. So if there are any costs being passed on to producers, we can thank you for those costs up to the point that you've laid them in our lap and we've at least had a chance to determine from information from your agency exactly how and where you stand.

So I don't want people to think that it is the Congress who is raising people's interest rates out there through the Farm Credit Administration, it is through, I think, inaction or lack of action that has increased costs already.

I certainly understand that the reason we are here today is to provide a competitive rate for our farmers and our borrowers out there and our constituents. That is the only reason we should be here, or this whole thing ought to be held in the Banking Committee.

Mr. STENHOLM. Let me respond by saying that I don't hear anybody suggesting that we're going to ramrod anything through, because this member does not intend to have any part of ramrodding any quick fix about anyone.

What we are talking about is a $75 billion bank that's in trouble. And the reason we're in trouble is because all of our lending activities are in agriculture and it's a sick industry.

Now, if we were to allow things to happen as some in the administration have suggested up until this morning—that we just allow the open-market system to work—we're going to have a collapse that will make Continental Illinois' look like chickenfeed. But no one is talking about—I didn't hear this in Mr. Wilkinson's testimony, a ramrodding through. What we are beginning now is the process of hearing the alternatives that we can go through, and I suggest under the leadership of Mr. Jones, we're going to come up with——

Mr. WEAVER. Would the gentleman yield? Would the gentleman yield?

Mr. STENHOLM. I would be happy to yield.

Mr. WEAVER. I just want to say that my position is based on the fact that if we start bailing out financial institutions in this country, that the cost to the taxpayer in interest rates on $2 trillion worth of debt is going to go up, and go up sharply.

Mr. STENHOLM. Exactly.

Mr. WEAVER. That is going to hurt this whole country far more.

Mr. STENHOLM. I totally agree with that, and that's why I am kind of glad to hear $5 billion instead of $10 billion. I think that what we're talking about is a reasoned approach. But I don't know, it's the first I have heard about it, the first any of us have heard about it this morning, what we're talking about.

So I don't want to leave the impression that we're being ramrodded or stampeded. This committee, I do not believe, will be ramrodded or stampeded.

Mr. COLEMAN. Will the gentleman yield?

Mr. STENHOLM. Sure.

Mr. COLEMAN. Mr. Wilkinson testified that we have to act before the close of this year or these different things would happen. I would like to know how many legislative days we have left. I know how many we've got—about 5 or 6—on the floor of the House.

Mr. STENHOLM. If I might reclaim my time——

Mr. COLEMAN. And from that standpoint, we've got $5 billion less today than 2 weeks ago, and as I suggested earlier, if we wait 2 more weeks, we might save another $5 billion. But we have had this thing crunched to the end, and it's the calendar and it's the time sequence, and there is nobody necessarily to blame. All I am saying is there is a lot of information floating around here that we have to digest.

And I would not appreciate the gentleman trying to characterize further my comments. Let them stand for what they are.

But I think all these things have been said by Mr. Wilkinson. He wants us to act, it's imperative that we act. And we've got a little bit less than a month to act around here for this session.

Mr. STENHOLM. Well, I would just respond that what I am suggesting—at least in this individual member's mind, and that's for all it's worth—is some indication by the administration of a creditline or something to assist us as we have the time to develop a reasoned package. That I know the gentleman from Missouri is interested in doing. That's all I was suggesting.

Mr. WEAVER. Would the gentlemen join me in calling and asking for Secretary of the Treasury Baker to appear before this committee?

Mr. STENHOLM. Absolutely. I think that, as my first question of Mr. Wilkinson which goes back to the policies of IRS, the Treasury, and others over the last at least 9 years in responding to some of these questions, I think that we need to hear from some of those individuals who, in some small way, have helped contribute to the problem we find ourselves in today.

Mr. GUNDERSON. Mr. Chairman.

Mr. JONES of Tennessee. The time of the gentleman has expired. We will take that up later. We've got more important things to do today. We've got all the witnesses we can afford today.

Mr. Gunderson, do you want some more time?

Mr. GUNDERSON. You just said what I wanted to say.

Mr. JONES of Tennessee. OK. All right.

Well, I had a closing statement I was going to make, but he's not going to make it because of the time. But I want to say to each member of this subcommittee, all that I dearly respect, that I think some of this discussion that has gone on here in the last few moments is absolutely unnecessary. And I want to tell every member of this subcommittee and of the full committee and anybody else that is listening that this has not been a ramrodding situation overnight.

So I don't want anybody to go away from here with the wrong illusions about what has been going on, because we have been at work, and I want everybody to know that.

Mr. COLEMAN. Would the gentleman yield?

Mr. JONES of Tennessee. I would be glad to yield.

Mr. COLEMAN. I certainly withdraw the word ramrod. There is no ramrod in the sense of you pushing anything through or anybody else. All I was trying to say was that it appears that time is of the essence, time is limited, and therefore I characterized it as that.

Certainly, the gentleman has taken his time and even called off a hearing before to make sure that all the witnesses were here, and he did that at our request and agreement. Please don't take anything that I said to characterize it like that. The chairman knows my feelings toward him and how we've worked together, and Mr. Stenholm.

I just want everybody to know that that was a word that came to my mind simply because of the time crunch that we're faced with, and it also shows the frustration that all of us feel.

I represent a district which has more foreclosed loans than any other district in the country. We have more foreclosures in our district than any other State in the Nation. And, yes, it bothers me, yes, I get a little upset about it. And I don't think ramrod is that type of an emotional word.

But I don't want the chairman to think that I was trying to suggest anything as far as his activity.

Mr. JONES of Tennessee. Well, please understand, I meant nothing personal. I just wanted to let everybody understand how I feel about this situation because there has been a lot of work, and nothing that is temporary has gone on in this thinking today.

Nobody has a bill to submit or even any suggestions. And this is the purpose of these hearings, to see what the Governor has to say and then to see what others have to say tomorrow, and then I will hope that this subcommittee can get down to business and try to offer something, whether it be in this part of the 99th Congress or next year.

Thank you, Governor, Mr. Duncan, Mr. Edwards, Mr. Medero, for being here. I apologize for so much time, but I think it has been worthwhile.

Mr. **Wilkinson**. Thank you, Mr. Chairman, and members of the committee.

Mr. **Jones** of Tennessee. There will be no recess for lunch because there will be no opportunity to do that under the timeframe that we are operating in. I know that some people are going to have to have lunch, and we are all going to be part of that group. But at the same time, we're going to continue the testimony.

I want to call the next panel.

Mr. Ray Moss Tucker, chairman of the Farm Credit Council of Washington, and a farmer of Finchville, KY; Mr. James Roll, senior vice president of the Federal Farm Credit Banks Funding Corp. in New York; and Gene Swackhamer, president of the Farm Credit Banks, Baltimore, MD.

Mr. **Stenholm** [acting chairman]. If we could have order, we will go ahead and begin until Mr. Jones gets back.

Mr. Tucker.

STATEMENT OF RAY MOSS TUCKER, CHAIRMAN, LEGISLATIVE COMMITTEE, FARM CREDIT COUNCIL

Mr. **Tucker**. Mr. Stenholm, I am Ray Moss Tucker, a farmer from Finchville, KY, and chairman of the board of the Farm Credit Council. I serve also as chairman of the Farm Credit Council's Legislative Committee, and it is in that position that I appear before you today.

With me at the table is Jim Roll, senior vice president of the Federal Farm Credit Funding Corp. of New York, and Gene Swackhamer, president of the Farm Credit Banks of Baltimore.

They will testify both as to Wall Street and to our proposal that we will present to you today after I have completed my testimony.

Mr. Chairman, I would like my entire testimony to be made a part of the record. I will go through and just hit the highlights of what we have to present.

The banks and associations that make up the Farm Credit System are directed, by law, to serve the credit and financial service needs of U.S. agriculture. They are farmer-owned and farmer-directed organizations dedicated totally to the moving of capital on a dependable basis from the Nation's money markets to U.S. farmers, ranchers, and their cooperatives. They exist for no other purpose.

At a meeting in mid-September, the board of directors of the 37 farm credit banks received a report on the financial condition of our system and the market conditions for our Farm Credit Systemwide securities. Using USDA forecasts as well as our own, directors were briefed on the anticipated further deterioration in the Nation's farm economy over the next 2 years.

The unanimous conclusion was that, absent Government financial assistance, the system cannot survive this radical transition that is underway in agriculture.

I might add at this point, Mr. Chairman, that I appeared before this subcommittee—or the entire committee—in the spring to talk about agricultural income and the Farm Credit System. And at that point I made the statement that the trouble in the farming community today was not credit, it was income and profitability in agriculture.

Mr. Chairman, I have been a long-time farmer-borrower from the PCA, president of a large borrowing cooperative, and for 6 years, a member of the Louisville District Farm Credit Board. I am proud of our farmer-owned system and of Congress for having the foresight some 70 years ago to establish it.

All of the system institutions have played a critical role in the development of U.S. agriculture. We believe that we have lived up to the intent of Congress that the Farm Credit System has provided a dependable source of credit to agriculture.

We are most proud of the fact that in 1968 the Farm Credit System became entirely farmer-owned when Federal capital was repaid. Because we have been farmer-owned and directed for the past 17 years, our request for Federal assistance today is one of the most difficult decisions that we have had to make as an organization, but, frankly speaking, we have no other choice.

We have $13 billion of problem loans, with exposure to loan losses of $3 billion or more, and another potential of $3 billion of operating losses in 1986 through 1987. It's a problem which has been developing for several years and which we have been trying to solve without Government assistance for well over 2 years now.

Our problems are driven, not by the actions of a single borrower or association or any combination thereof, but by an industry being torn apart by large supplies, declining exports, deflation, and some of the highest real interest rates in history—all of which led to some of the steepest drops in land values ever in our history.

Land values throughout the North Central and Midwestern States have fallen by over 50 percent in the last 5 years, and the worst may not be over.

Some of our critics will argue that the system made decisions which brought about the very problems we are trying to come to grips with today.

Hindsight is always 20–20. It points out the mistakes of the farm credit banks and associations, commercial banks, farmers, farm journalist, agribusiness, land-grant university economists, and even Government policies which encouraged fencerow-to-fencerow planting.

Most of our $13 billion in now-troubled loans were sound loans when they were made, both from the standpoint of collateral and repayment. And most of them were made to good farmers. Further, we didn't, and they didn't, mismanage the whole of rural America.

Bad loans alone are not the cause of the serious, underlying problems in agriculture that we are working to solve. No one could have forecast the dramatic devaluation in the balance sheet of U.S. agriculture, and no financial institution with its assets fully in that industry could have been capitalized high enough to weather the shock moving through this industry.

In the Louisville district, for example, we currently have almost 3,000 loans totaling $537 million on which payments aren't being made. And we do at this point think we can project another 11,000 additional loans amounting to $1.5 billion which may be in trouble next year.

What we propose today is a program of continued self-help among those farmer-owned organizations with a lifeline or safety net to Government. I emphasize this is continued self-help. The financial stress among farmers and its impact on these institutions are subjects we have been facing for several years. Our goal has been to ensure that the Farm Credit System continued to be a reliable source of credit at the lowest reasonable cost to farmers, ranchers, and their cooperatives.

I would like to highlight a number of the comprehensive self-help measures taken by the system to date and enter my complete statement for the record.

First, at the district level, carefully planned loss-sharing agreements were entered into among the PCA's.

Second, on a case-by-case basis, district banks have provided financial assistance under agreements entered into between the assisted association and it supervising bank.

Third, interdistrict capital preservation agreements were set in place. Special interdistrict assistance programs were developed and applied for the first time in 1985, to assist the Spokane and Omaha Federal Intermediate Credit Bank. To help these two banks alone, the other banks of the system committed a total of $476 million—$136 million for the Spokane FICB and $340 million for the Omaha FICB.

Fourth, the 37 farm credit banks chartered and capitalized the Farm Credit System Capital Corporation—headquartered in Wichita, KS—specifically to acquire—on behalf of all 37 banks—the nonaccrual assets of troubled banks in Spokane and Omaha.

Fifth, to better protect the farmer-borrower's stock investment, to cut costs and achieve operating and organizational efficiencies, a number of districts have developed—and some have implemented—proposals to pool the capital of the PCA's within the district through consolidations of associations into single, districtwide organizations.

Sixth, we've established single, in many cases, farm credit service centers.

Seventh, we've consolidated management of the district banks, and we see this to be a more effective use of executive talent, reduced overhead, and improved coordination in credit programs and service.

Eighth, we've cut staff. In 1985 we will have reduced systemwide employment by 10 percent—over 1,700 people—to an estimated 15,600 by the end of this year. Some district banks have suffered staff cutbacks of 30 percent. This represents a cost savings of approximately $60 million a year.

Ninth, the system banks and associations have recognized their losses, $1 billion in the last 3 years and more than $1 billion to come.

Mr. Chairman, the actions have not been universally popular, but they have been undertaken in good faith and with critical input from farmer-borrower stockholders. On the one hand, we see firsthand the gut-wrenching problems which result in the lack of profitability in agriculture. On the other hand, as directors, we set policies to maintain the viability of our associations, even though this may result in higher interest rates to farmers.

Perhaps it is because we are farmers and believed that the agriculture economy would turn around that we have stayed with many farmers as long as we have. Some would say we've stayed too long, or else we wouldn't be projecting $6 billion in nonaccrual loans by the end of this year and $13 billion over the next 2 years. Many of these loans would have been liquidated over the past 6 years had we pursued more aggressive credit administration practices.

We have worked hard to carry out our responsible policy of forbearance; but there are still at least three problems with the policy of forbearance: One, you can never have done enough of it; two, it can only be rationalized if there is a reasonable expectation that financial health will be restored to the borrower, or in this case, the industry; and three, it costs money—in the form of carrying cost on nonaccrual loans—and this cost is borne by the remaining borrowers through higher interest charges.

Frankly, these costs have come home to roost. The resulting higher rates are driving farmers who can't refinance toward bankruptcy at an accelerating rate. These same higher rates are driving farmers who can refinance to other lenders. Still others flee out of fear that their stock investment in system institutions will soon be lost. The result is a downward spiral of confidence and capital base for the system as a whole. During the first three quarters of 1985, the loan volume of the farm credit banks fell by over $6 billion.

We know the importance of helping farmers get through the tough times. After all, many of these same farmers helped build the Farm Credit System. But we also recognize that realistically some farmers still aren't going to survive even with maximum forbearance, in the light of profitability in agriculture today.

Mr. Chairman, the Farm Credit System has a solid record of assisting agriculture and repaying the Government capital it was provided in the early years. The Government's initial investment was a partnership with America's farmers. Now, 17 years after we have repaid that initial investment, we are once again asking you to help us ensure that the Farm Credit System continues to be able to live up to its congressional mandate.

We have tried, and we will continue to try, to solve our financial problems with our own resources. But these resources simply aren't going to be enough. We need your help now in this session of Congress. I reiterate again, we have a $13 billion problem, with little or no profitability in agriculture.

Thank you.

Now, Mr. Chairman, I would ask Jim Roll to present the financial side.

[The prepared statement of Mr. Tucker appears at the conclusion of the hearing.]

STATEMENT OF JAMES A. ROLL, SENIOR VICE PRESIDENT, FEDERAL FARM CREDIT BANKS FUNDING CORP.

Mr. ROLL. Mr. Chairman, I am James Roll, senior vice president of the Federal Farm Credit Banks Funding Corp. located in New

York City. Unlike many financial institutions which generate loanable funds primarily through deposits, the Farm Credit System funds itself almost entirely through the issuance of securities in the capital markets. Currently, securities outstanding total nearly $70 billion.

Our role at the Funding Corporation is to direct the marketing of the securities of the 37 farm credit banks. We work with an independent selling group of approximately 150 securities firms and bank dealers who offer farm credit securities on a worldwide basis. Our investors include commercial banks, savings and loan associations, individuals, insurance companies, States, and municipalities, pension and money market funds, foreign banks, and governments and others.

Today I will discuss the financial condition of the Farm Credit System, how the financial community has reacted to the current agricultural situation and its impact on the Farm Credit System.

Like other financial institutions, the Farm Credit System is subject to a wide variety of influences, both real and perceived, which affect our ability to successfully market our securities. This, in turn, affects both the interest rates which we charge to farmers and our financial statements. With a depressed agricultural economy and a fragile market for our securities, these influences have a more pronounced impact.

First, it is important to understand that although we clearly state that Farm Credit System securities are not an obligation of, nor are they guaranteed by the U.S. Government, the market for system securities is nevertheless supported by a firmly held belief that because we are a Government-sponsored financial institution, our securities are backed by the Government of the United States. This is why there continues to be a market for our bonds today despite our growing financial problems.

As Mr. Tucker said a few moments ago, the Farm Credit System has identified potential nonearning assets of about $13 billion and a potential exposure to loan losses of $3 billion or more by December 31, 1987.

Mr. Tucker also spoke to the upward pressure on interest rates charged to farmers and cooperatives that results from the rapidly increasing cost of carrying these nonearning loans and acquired properties. As the financial markets become more uneasy with our financial problems, our increased costs for funds will result in interest rates to farmers that are even higher.

Heightened investor concern could mean that we become unable to market securities at all, and thus would not be able to repay our existing securities when they mature. As our interest rates rise, we lose our best borrowers. If we lose access to the market, we would soon default on our obligations. This is what the Farm Credit System faces absent Government financial assistance. With that brief preface, I would like to discuss what has already happened in the markets.

The financial community did not begin to focus on the problems in the agricultural economy until late 1984 or early 1985. Concern about agricultural conditions was heightened last spring, with major articles focusing on agriculture's problems.

At the same time, the system's regular quarterly reports and periodic press releases on the financial condition of the farm credit banks increasingly pointed out the adverse industry trends that were affecting system borrowers. While investors showed some concern about the problems of individual farm credit districts, overall they continued to believe, as we did at the time, that the total system remained financially sound.

By early summer, this view began to change. Depressed commodity prices and slumping land prices began to be reflected in system financial statements. In mid-July concern was heightened by reports that the system would experience significant loan losses. Our funding costs increased about one-quarter of 1 percent in late July.

During August, the system released results of second quarter operations, projecting that the 37 farm credit banks would incur an operating loss for the third quarter of 1985 and, based upon what was known at that time, might incur an operating loss for the year.

During the first week of September the market received the news that plans were being made to seek Federal financial assistance for the Farm Credit System. While this news was taken adversely, questions of even a more serious nature were raised concerning the number and amount of loans which might be uncollectible and how high our losses might run.

Wall Street reacted quickly, and as a result, the cost of new sales of farm credit securities increased another one-half to three-quarters of 1 percent above the U.S. Treasury rate. Toward the end of September, spreads over Treasury rates stabilized in the three-quarter to 1 percent range.

But this stability didn't last very long. During the second week of October, the market was shaken again. The system's cost of funds increased an additional one-eighth to one-quarter percent, but a more important result was that the system can no longer sell issues of the size and in the maturities that fit its funding needs. Spreads are now between 1 and 1.25 percent over the Treasury rates.

The so-called shocks to the markets have a real impact. To give you a quick example, each year we market about 100 billion dollars' worth of securities. If our costs are 1 percent higher, the added cost on that $100 billion is $300 million in the first year alone, and that cost is ultimately paid by the farmers.

While our costs of funds is important, the impact on the market for farm credit securities has gone far beyond the cost consequences alone. We have lost many of our traditional investors in farm credit securities who purchased them as a direct substitute for U.S. Treasury securities. System issues were quality investments. Now, because of the questions about our future, these investors have either sold their holdings or are holding them to maturity and not reinvesting.

Who are these traditional buyers? They include commercial banks, State and local governments, mutual funds and other institutional investors, who, because of their fiduciary responsibilities, must be able to show that they have invested prudently. Because of the problems which we have and are trying to solve and the questions which others are raising about the Farm Credit System, it is very difficult for these investors to justify why they should continue to purchase system securities.

Mr. STENHOLM. Excuse me, Mr. Roll. Could we interrupt you right there? We will take a brief recess. We have about 4 minutes to a vote, and Mr. Jones should be back just shortly. So we will have a brief recess right there.

[Recess taken.]

Mr. JONES of Tennessee. The subcommittee will resume its hearing.

Mr. TUCKER. Mr. Chairman, we were in the middle of Mr. Roll's testimony. If it's OK, we will let him continue.

Mr. JONES of Tennessee. Yes, sir. I have been advised of that.

Mr. Roll, if you would like to, you may proceed.

Mr. ROLL. OK. We were talking about who had traditionally purchased the farm credit securities and that these traditional buyers are no longer the major buyers of farm credit securities.

Consequently, the Farm Credit System has attracted a new type of investor, one who is willing to purchase our securities and will accept risks for a price. This investor believes that our securities represent an opportunity to earn a high return because they ultimately believe that the Federal Government will not let the Farm Credit System default.

If, however, the day should come that serious questions are raised about the commitment of the Federal Government to the Farm Credit System, this new investor will also abandon system securities and the source of funds for farmer loans could dry up, regardless of price.

Last week, the system issued its third quarter financial report. In it, losses for the combined 37 farm credit banks were reported as a loss for the first time since the 1930's. These losses totaled $522 million for the quarter and $426 million for the 9-month period ended September 30. These losses were a direct result of a substantial provision for loan losses and the cost of the financial assistance package for the Omaha Federal Intermediate Credit Bank.

In view of depressed net farm income and declining farmland values, particularly in the Midwest, earlier this year we undertook a special nationwide credit review of the Federal land banks. This was initiated to help determine the likelihood of land bank borrowers repaying their notes, both principal and interest. This review showed that approximately $6 billion of the $48 billion in loans outstanding are currently undercollateralized by approximately $900 million. That is, the land serving as collateral is worth less than the mortgage on the land.

As a result of this study and a general deterioration in our loan portfolio, the provision for loan losses was $675.9 million for the first 9 months of 1985, compared to $77.4 million for the same period last year.

In addition, nonaccrual loans increased during the third quarter to $3.5 billion, or almost 5 percent of loans outstanding, nearly double the amount reported on June 30, 1985. Nonaccrual loans are those on which accrual of interest has been suspended because of substantial doubt about the ultimate collection of principal and interest.

Based on the special credit review of the Federal land banks and other economic studies, the farm credit banks may be exposed to loan losses aggregating $3 billion or more during the 1985–87 period, for which an allowance of loan losses of approximately $1.1 billion has been established as of September 30, 1985.

While I cannot predict the fourth quarter results for the system, I can tell you that we will make the necessary additions to the allowance for loan losses based on a further analysis of the loss exposure in the bank's individual loan portfolios.

We stated in our quarterly report that the level of nonearning assets between now and the end of 1987 may be $10 billion or more. Obviously, not all nonaccrual loans will result in losses to the system. However, the cost of carrying this magnitude of nonearning assets and absorbing $3 billion or more in loan losses will likely result in multibillion dollar net operating losses for the next several years.

I believe the market for farm credit securities would not tolerate losses of this magnitude without explicit evidence of Government assistance.

We are striving to accurately reflect where we are and appropriately disclose information as soon as it is known by the banks. Furthermore, we are very sensitive to the necessity for public confidence. This was the primary reason that the system retained the services of Price-Waterhouse & Co. as auditors this year. They have been working in each farm credit bank toward the objective of presenting audited financial statements for the year ending December 31, 1985. I am confident that the farm credit banks will take whatever actions are necessary to earn an unqualified opinion from Price-Waterhouse & Co.

As I indicated earlier, each year we at the Funding Corporation issue upward of $100 billion in bonds and discount notes on behalf of the Farm Credit System. While this total will be reduced somewhat this year as a result of loan payoffs on a continuing basis the system needs to rollover outstanding debt of approximately $70 billion.

Continued deterioration in the financial condition of the Farm Credit System without explicit Government assistance will increase the risk that the system will not be able to meet its funding needs at any cost. This could ultimately result in an immediate financial crisis in terms of the system's ability to meet its maturing obligations. At the end of the third quarter, the 37-bank liquidity—that is, the investments in liquid securities and cash—amounted to $5.3 billion. This is our cushion of liquid assets that would be used to retire maturing bonds and discount notes in the event the system were unable to go to the market. On average, the system must raise over $1.5 billion each week. In other words, absent Government financial assistance or intervention, the system could continue in business for about 18 days if it were unable to market its obligations.

I would also like to comment on the proposal that was discussed about sharing with the bondholder in these losses. These bonds were sold with the promise that the net worth of the Farm Credit System stood behind these bonds and any losses the system might incur. That was a promise we made at the time we sold those bonds. That was the basis we sold these bonds on.

To do any less than keep that promise would be, in my opinion, unthinkable as far as the bondholder is concerned. And I do not believe that Wall Street would ever again buy a farm credit bond if we backed away from that promise that we made when we sold those bonds.

Mr. Chairman, the Farm Credit System is at a major crossroads in its history. We continue to believe that we have provided sound lending to farmers, ranchers, and their cooperatives within the limits established by Congress. We can continue to fulfill that mission, but in my professoinal opinion, we will not be able to do so without Government assistance to ensure investor confidence in the financial stability of the system.

Thank you.

[The prepared statement of Mr. Roll appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Roll. We appreciate your being here and for that very good statement that you made.

Now to Gene Swackhamer, president of the Farm Credit Banks of Baltimore.

Gene.

STATEMENT OF GENE SWACKHAMER, PRESIDENT, FARM CREDIT BANKS OF BALTIMORE, AND MEMBER, LEGISLATIVE COMMITTEE, FARM CREDIT COUNCIL

Mr. SWACKHAMER. Thank you, Mr. Jones, members of the subcommittee. I am Gene Swackhamer, president of the Farm Credit Banks of Baltimore. I appear here today as a member of the legislative committee on behalf of the Farm Credit Council.

Mr. Chairman, today we are seeking the assistance of Congress and the Federal Government to avert two potential crises of serious proportion for American agriculture and the Nation's economy.

The first is a potential funding crisis and the need to immediately restore investor confidence in the Farm Credit System and the securities it must sell to fund one-third of the Nation's farm debt and one-half of the farm real estate debt.

The second is a potential financial crisis as the precipitous decline in farm real estate values and the lack of farm business profitability depletes the financial resources of the farm credit banks, associations, and their farmer stockholder-borrowers.

These conditions further compound the problems of a downward-spiraling farm economy, leading to a crisis of confidence by farmer borrowers and their cooperatives in the Farm Credit System. The system's deteriorating financial position leads directly to questions of Farm Credit System reliability as a source of credit at reasonable rates.

Mr. Roll has already described how Wall Street has reacted to the system's problems. In the space of 3 months, farm credit securities have gone from a better-than AAA investment to being described by an article in the October 28 Washington Post as "junk bonds." This story and a related one revealing that Standard and

Poors had under consideration a change in their rating of system securities have heightened investor concern about system viability absent Government financial assistance.

The ripple effect of a Farm Credit System default on farmers, the financial markets, and on our Nation's economy in general would be devastating. Chase Econometrics is analyzing this issue in some detail for us, and their preliminary findings show an impact more on the order of a tidal wave than a ripple.

A system default would mean approximately 90,000 additional farm operators would have their loans foreclosed in the first year after the default on system obligations. Interest rates paid by farmers likely would increase by 3.5 to 4.5 percent. And there likely would be a $22 to $39 billion credit shortfall to meet agricultural production expenses.

Because of their holdings of Farm Credit System securities, the 3,900 agricultural banks throughout rural America would lose over a third of their capital. As a whole, the Nation's banking industry would lose close to 10 percent of its capital in the first year and would experience additional losses as other agricultural loans go bad.

Secondary economic impacts are no less dramatic. Interest rates outside the agricultural sector would likely increase by 2.5 to 3 percent, resulting in slower growth in the economy. An estimated 1.5 million jobs would be lost. An increase of $53 billion in the Federal deficit would occur.

Shocks to the economy of the nature being estimated in this study can be prevented with explicit Government guarantees and financial assistance. The first requirement is to stabilize the market for system obligations. This will ensure the continued flow of capital to farmers through the Farm Credit System while it reduces system funding costs and helps prevent significant and devastating increases to farmers' interest rates.

In my opinion, this will calm Wall Street. But the Chase study confirms that the reasons for allaying Wall Street concerns about the quality of farm credit investments extend far beyond the system and the farm economy.

We have considered the usefulness of Federal guarantees on system securities. It is only a partial solution. It does not ensure that the system will have the capital resources necessary to permit restructuring of nonperforming loans, holding of liquidated property off the market, or absorbing significant loan losses without forcing the system to substantially raise interest rates.

The second problem that we must face is how to solve the critical financial problems of farmers and their Farm Credit System. According to USDA's data as of January 1985, farmers leveraged greater than 40 percent who also had negative cash-flows in 1984 owed the Farm Credit System $18.7 billion. Those in the most immediate trouble—having both a debt-to-asset ratio of greater than 70 percent and negative cash-flow—reported that they owed the system $8.6 billion from borrowers leveraged over 70 percent with negative cash-flow. And of this amount, $3.5 billion already exceeded 100 percent. The system will incur significant losses which will further deplete the system's capital, regardless of the efforts made to collect the loans.

At yearend 1984 the 37 farm credit banks, together with production credit associations and Federal land bank associations. had total risk funds—capital and loss reserves—of $13.1 billion with nonaccrual assets amounting to $2.5 billion. By September 30, 1985, risk funds had dropped to $12.8 billion and nonaccrual assets had jumped to $5.3 billion. By the end of 1985, we project that nonaccrual loans will reach $6 billion. The magnitude of the loss for calendar year 1985 is dependent on the necessary addition to the allowance for loan losses which will result from loan portfolio studies currently being performed in the fourth quarter.

As Mr. Roll testified, we expect that some $13 billion in loans now outstanding will fall into the nonaccrual status in the next 2 years. Even with aggressive management of troubled loans, the level of loans and nonaccrual status is now forecasted to reach $11 billion by December 31, 1987, at which time risk funds of the system are projected to have fallen to $6.9 billion. Of that $6.9 billion, however, $4.9 billion will be farmer-invested stock. In other words, at that point in time, if all the surplus and loss reserves of the 37 banks and nearly 700 associations were combined into one account, the system would have to net $9 billion in recoveries on $11 billion in nonaccrual loans to avoid impairment of farmer-borrower stock throughout the system.

Given the current condition of the agricultural economy and the required rapid movement of land onto already depressed real estate markets, it is very unlikely that the system can avoid significant impairments of farmer-borrower stock.

Frankly, we do not think it is very likely that the system could endure through 1987. With rising loan losses, increasing costs of carrying nonearning assets resulting in successive years of multibillion dollar operating losses systemwide, we believe the investors would, in fact, abandon the system prior to yearend 1987, without Government financial assistance.

Even if the Federal Government can give some assurance to the financial markets, an equally serious problem remains for the system's farmer stockholders. The flight of some borrowers who have the financial condition which permits them to seek another lender will do so if the Government does not assist the system. This, too, hastens the ultimate financial collapse of the system as farmers' capital is withdrawn, leaving the burden to other now-sound farmer stockholders.

Mr. Chairman, as we considered the options for Government assistance, we have been ever mindful that almost $11 billion of the $13 billion in nonaccrual loans expected by the end of 1987 will surface from within the Federal land bank portfolios. As the holder of one-half the U.S. farm real estate debt, we are greatly alarmed by the likely consequences upon the farm real estate values and the total farm economy, if the land banks having almost 20 percent of our loans in the process of liquidation in the next 2 years.

This underscores the unique role and responsibility of the Farm Credit System in relation to the farm economy. It is on the basis of this special role and responsibility that we call upon the Congress to once again join with the Farm Credit System in a program of system self-help and Government assistance to help farmers, ranchers, and their cooperatives through this most difficult period for American agriculture.

The objective of our proposal is brief: to help restore stability to farmland values and to assure farmers, ranchers, and their cooperatives that credit will continue to be available at a reasonable cost through the farmer-owned and directed Farm Credit System.

We stand ready to work with you and your staff in preparing and perfecting draft amendments to the Farm Credit Act that would permit these farmer-owned institutions to implement self-help measures through the Farm Credit System Capital Corporation, as mentioned by Mr. Tucker.

The Capital Corporation is a service corporation chartered by the 37 farm credit banks in 1985 for the purpose of mobilizing system resources and overseeing system financial assistance to the Omaha and Spokane Federal Intermediate Credit Banks and their related associations.

We believe that the concept of self-help embodied in the activities of the Capital Corporation is sound, and that if the Farm Credit Administration is authorized to supplement the resources of that corporation through temporary loans, it is the most efficient vehicle to aid the farmer-owned and directed Farm Credit System. It is in place, operating and, we believe, with minor additions to its authorities, it could readily be used to facilitate a program of assistance for troubled institutions of the system while also moderating the otherwise extreme effects of rapid adjustment that is occurring in U.S. agriculture.

Specifically, our proposal would: empower the Farm Credit System Capital Corporation to serve as a financial warehouse through which system institutions and Government would share in the mounting costs of carrying nonaccrual loans and acquired properties marked to economic value and in other temporary financial assistance essential for the survival of troubled farmer-owned system institutions.

The proposal would authorize the Capital Corporation to mobilize available system capital through assessments on system institutions, consistent with standards to be established by the Farm Credit Administration. These standards would guard against undue increases in interest rates to farmers in contributing districts, and so that district institutions can plan for their own financial affairs, such annual assessments could not exceed one-half of 1 percent of the interest accruing assets.

The proposal would, incorporating moneys now available through FCA's present revolving funds, authorize FCA to immediately supplement system financial self-help measures through a provision for loans from the U.S. Treasury of up to $6 billion, not to exceed $2 billion in any fiscal year.

The proposal would require the system to repay assistance with interest through assessments by the Capital Corporation as system institutions are able to repay consistent with regulatory standards established by FCA.

The proposal would require, consistent with conditions of prior Federal assistance to the system, the payment of annual fees equal to the Government's cost of funds, or 25 percent of system earnings, whichever is the lesser, for so long as such loans are outstanding.

The proposal would maximize local accountability by requiring that as a condition of assistance through the Capital Corporation, a troubled bank or association shall have first reasonably drawn upon the financial resources of other institutions within its district.

The proposal would supplement the existing powers of the Capital Corporation to provide it with the operational tools and flexibility that are necessary to carry out its broadened responsibilities.

The proposal would provide for the continued local loan administration, restructuring, and management of troubled loans, related assets, and acquired property.

The proposal would cause FCA to set regulatory guidelines for loan restructuring and property management, taking into account such things as local farm real estate market conditions, production value of real estate collateral, conditions under which foreclosed property may be leased back to qualified borrowers, terms under which system institutions will secure the amount of any deferred principle through participation in future appreciation of collateral or other means. Such guidelines would be implemented in policies of the Capital Corporation and would apply in districts which receive intersystem or Government assistance.

The proposal would authorize FCA to increase the legal debt-to-capital limits for production credit associations—now at 10 to 1—to up to 20 to 1, thus avoiding many otherwise necessary liquidations of troubled PCA's.

In addition, Mr. Chairman, we recognize that as a part of any Federal financial assistance, the public must be assured of the safety and soundness of its investment in the system. As a part of such assistance, the system will support legislation which will provide enhanced regulatory powers for the Farm Credit Administration, coupled with a withdrawal of the agency from participation in the management and business policy determinations of system institutions. We believe that the enforcement powers of the Farm Credit Administration should be no less than, but neither should they be greater than, those exercised by other Federal regulators of financial institutions.

Mr. Chairman, my time has expired, but I have about three more pages on the benefits that we would expect to accrue from this proposal. If you would grant me that time, I would cover it. Otherwise I will not.

Mr. JONES of Tennessee. Without objection, you may proceed.

Mr. SWACKHAMER. Thank you, Mr. Chairman.

With these additional authorities and with financial assistance from the Federal Government, we believe farmers benefit as costs of carrying nonaccrual assets are shifted off the books of troubled banks and associations; and costs of system borrowing are reduced as investor confidence is restored, thus reducing pressure on interest rates.

We believe farm foreclosures and bankruptcies are minimized as a direct result of financial assistance that permits more orderly and reasonable workout in restructuring alternatives under FCA regulatory guidelines.

We believe that the proposal would affect farmland values through stabilization as financial assistance in carrying nonearning assets relieves the pressure on troubled institutions to rapidly sell properties in inventory. By restructuring troubled loans to reflect production values for farm real estate collateral, the system institutions will signal the market that an underlying value is being established for farmland by the Nation's principal farm real estate lender.

Finally, we believe the proposal would help the Farm Credit System continue as a viable and dependable provider of credit and related services at reasonable costs, owned by and dedicated exclusively to serving U.S. farmers, ranchers, and their cooperatives.

Now, the impact of no assistance is significant. As single industry lenders with their loan assets totally dependent upon a rapidly deteriorating farm economy, the banks and associations of the Farm Credit System are being squeezed in a financial vise. With rising costs of funding and increasing levels of nonaccrual assets, they can either raise interest rates to farmers, a substantial portion of whom cannot pay the present interest rates, or suffer other consequences. This further aggravates the financial plight of those who cannot refinance and drives away those who can.

As interest rates increase, the system's capital and earnings base erode. And as the institution feeds on itself, the investors demand ever higher rates until they finally will just quit purchasing system securities entirely.

Now, faced with these alternatives, and absent Government financial assistance, system banks and associations will be forced to minimize the rate of capital erosion by the following actions:

We would have to accelerate the collection of delinquent loans to minimize the burden of nonearning assets.

Increasing interest rates to borrowers to cover the higher costs of purchased money and the carrying costs of nonaccrual loans and acquired properties would be necessary.

Aggressively marketing inventoried properties, resulting in additional stress on the already depressed and soft farm real estate markets would result.

Pressing forward with widespread consolidations of associations to most efficiently utilize capital remaining within the system would be necessary.

Finally, the Farm Credit Administration has indicated that without financial assistance, at least 40 production credit associations will be liquidated or forced to consolidate within a few months. As many as three Federal intermediate credit banks, and two Federal land banks will meet the same fate within a year. The result would be serious loss of confidence and stockholder investments by hundreds of thousands of the system's farmer and cooperative borrows.

Mr. Chairman, the systemwide obligations which fund the operations of the Farm Credit System are the joint and several obligations of the 37 farm credit banks. As you heard Chairman de la Garza say, we are in debt together and the inability of the system to market those securities could bring the total of the system to its knees in less than 3 weeks.

This fact often masks the reality that these banks and associations are not a single institution, but rather, they are a group of farmer-owned and farmer-directed, locally based farm lending corporations as cooperatives knit together by a common charter act, a common regulator, and their coresponsibility on obligations issued through a common funding source. Thus, absent a collapse of the bond market, the financial problems facing the system will not bring it crashing down all at once. At an accelerating pace, however, individual institutions will fail, association by association, and ultimately bank by bank.

It must be emphasized, though, that the farmers and cooperatives who borrow from these institutions own them as well. They are the ones who would be helped most by assistance to these institutions. The converse of this statement, though, is just as true. Those who will be hurt most should the Farm Credit System not receive financial assistance will be those same borrowers and owners of the Farm Credit System banks and associations—some 1 million U.S. farm families.

We believe it is imperative that steps be taken in this session of the Congress to restore both farmer and investor confidence in the Farm Credit System. We dare not leave the financial markets unsettled while Congress is in recess, and farmers must be assured now that their Farm Credit System will continue as a dependable provider of credit and related services in 1986 and subsequent years. We believe that a mechanism for financial assistance must be in place before farmers come in to set up their refinancings for 1986.

For the Farm Credit Council and its member banks and associations of the Farm Credit System, we offer these proposals for your urgent consideration. As you consider them, we urge you to remember why your predecessors in the Congress established the Farm Credit System, the excellent record of service to agriculture and the fact that the system has already proven its credit record to the U.S. Government. It has repaid its Government capital in the past, and it will do so again.

Thank you, Mr. Chairman, for this opportunity for us to present our views on this very important matter.

[The prepared statement of Mr. Swackhamer appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Gene, for that statement.

We do appreciate all three of you being here.

Now I recognize Mr. Coleman for 5 minutes of questioning.

Mr. COLEMAN. Mr. Roll, you said in your testimony that farm credit securities are not an obligation of the U.S. Government or guaranteed by the Government, but there is a firmly held belief by investors that they are backed by the Federal Government.

You also said, in alluding to a suggestion about guaranteeing or not backing up the bonds that are outstanding already that the administration of the system sold their bonds based upon the statement and pledge that the net worth of the Farm Credit Administration stands behind those bonds.

Is that a fair characterization of what you said?

Mr. ROLL. Yes; that's fair. I said that they were a promise that the net worth of the system stood between the bondholder and any loss.

Mr. COLEMAN. Right. And that is not a Government guarantee, it's——

Mr. ROLL. That is not a Government guarantee.

Mr. COLEMAN [continuing]. Different.

Mr. ROLL. That's correct.

Mr. COLEMAN. Now, would you agree with Mr. Edwards that the net worth of the Farm Credit Administration consists of stockholder investment of $5 billion?

Mr. ROLL. At the bank level, the 37 farm credit banks, the net worth consists of the stockholder investment plus the retained earnings.

Mr. COLEMAN. Right. Which is, he told us, $5 billion.

Mr. ROLL. It's more than that.

Mr. COLEMAN. Well, he told us the stockholder investment was $5 billion, that the net worth, not counting that stock, was $5.5 billion, and there was a loan loss reserve of $1.6 billion.

Mr. ROLL. That's correct.

Mr. COLEMAN. All right. So we all agree on those figures.

Mr. ROLL. Correct.

Mr. TUCKER. Mr. Coleman, we have a chart here that would show that if you would like to see it.

Mr. COLEMAN. All right. Well, let me pursue this. If we all agree on that, let me pursue the question further. Then is this same concept of net worth what you alluded to on page 8 when you said that the 37 banks have as of the third quarter liquid securities and cash amounting to $5.3 billion? That is the so-called net worth?

Mr. ROLL. They do not relate.

Mr. COLEMAN. They do not relate?

Mr. ROLL. They do not relate. The $5.3 billion of liquidity is actually liquidity. In other words, it's the cash we have in our pockets, the investment securities, the cash that we have that we can use to pay off our debts.

Mr. COLEMAN. And that is not part of your earned net worth?

Mr. ROLL. It may or may not be. The earned net worth is invested in a broad range. Part of it's invested, that part of it invested in loans, but you cannot relate the two directly. One is an asset, and one is net worth.

Mr. COLEMAN. OK. Then Mr. Swackhamer has in his testimony, he characterizes this phenomenon as capital and loss reserve, or risk funds is the word you use. Are we talking about the same thing now, or is this a different concept? What are risk funds?

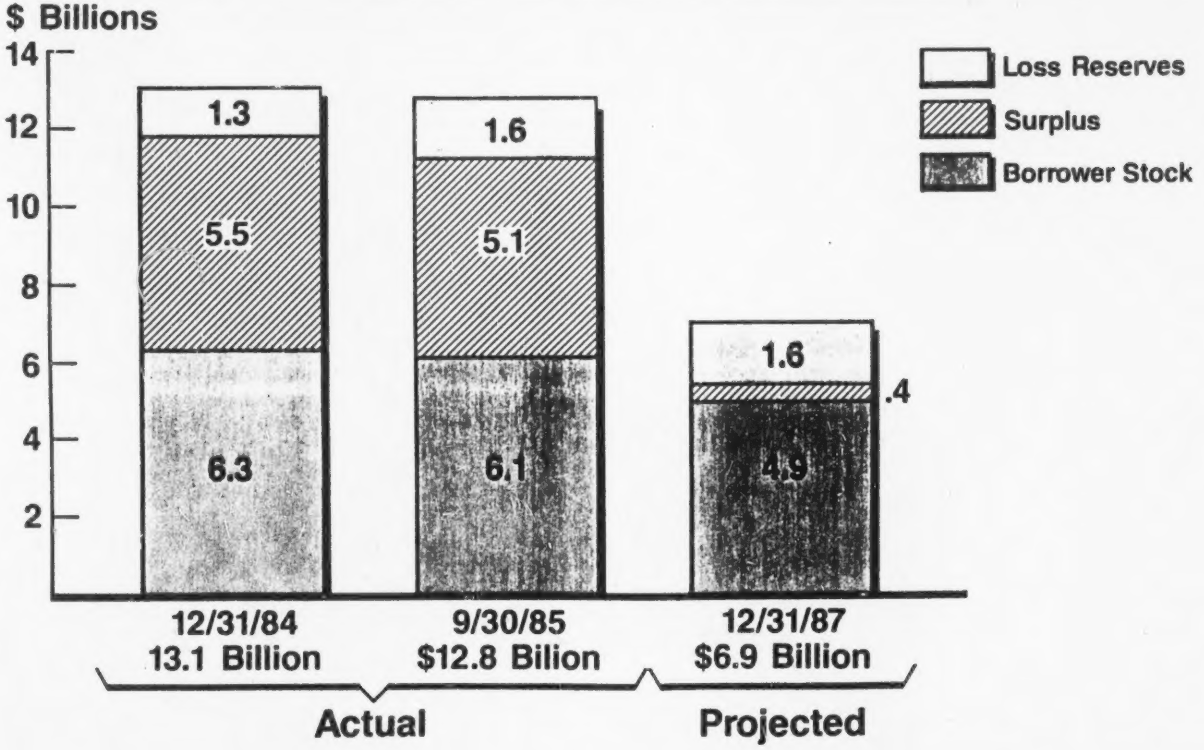
Mr. SWACKHAMER. No; we're talking about similar concepts. Mr. Coleman, I would like to show you a chart and talk about risk funds. I think it will help clarify the difference between capital net worth and risk funds.

[The chart follows:]

FARM CREDIT SYSTEM

TOTAL RISK FUNDS

BANKS AND ASSOCIATIONS



Mr. SWACKHAMER. This is a chart which depicts the total risk funds of the 37 farm credit banks and all of the associations. So it's all we got, there is no more.

Now, what you see on the left-hand side is the column as of December 31, 1984, the lower portion in the brightest green represents the ownership interest of cooperatives and farmers. It is their stock. It is their allocated surplus. It is their property.

What shows above that is surplus that has generally been earned since the inception of these organizations. It is tax-paid surplus and PCA's and the banks for cooperatives. It is legal reserves of the Federal land banks.

Mr. COLEMAN. Is that net worth, earned net worth?

Mr. SWACKHAMER. It is earned net worth.

Mr. COLEMAN. OK.

Mr. SWACKHAMER. Above that is loss reserves. That's the reserves available to absorb chargeoffs that might be necessitated by failure to make repayment of loans. That's the total of $13.1 billion which has so often been referred to.

Mr. COLEMAN. Right. OK.

Mr. SWACKHAMER. Now, as of September 30, 1985, in the middle column, you will see the same categories reflected. The capital base has declined as some borrowers have left and some borrowers have repaid loans for other reasons. The surplus has declined somewhat as additional provision for losses have been made and other adjustments have been necessitated.

By yearend 1985 we have tried to project, based on what we foresee now, the need to evaluate our portfolio on a case-by-case basis, and we foresee that there will need to be significant additional contribution to provision for loss which goes into the allowance for loan losses in the balance sheet, and it can only come from one place. It must now come from surplus because we're operating at a deficit.

Mr. COLEMAN. OK. All right. Now, except for what Larry Edwards said was $5 billion in stockholder capital—you have it $6.1 billion, I believe—that's really the only two figures that were——

Mr. SWACKHAMER. Yes; he referred to the banks.

Mr. COLEMAN. OK.

Mr. SWACKHAMER. And this is banks——

Mr. COLEMAN. OK. That's a given.

Mr. SWACKHAMER [continuing]. And associations.

Mr. COLEMAN. You have dramatically shown the point that I was trying to make with Mr. Edwards. And that is, what is happening is, that your so-called earned net worth or what all these things are backed for is a dwindling concept. That's the point I was making with him, that it's really not anything you have tangible, it's not anything that's liquid. It may be the value of my house, but if my house goes down in value, it means nothing to me. Right now, your house is going down in value at an alarmingly high rate. Do you agree?

Mr. SWACKHAMER. That's correct.

Mr. COLEMAN. So, let's all understand that we're basing all of this on a concept of what it is today as opposed to where you think it's going, and it's an ephemeral concept. It's just what you think you would get today as opposed to what you would get 2 years from now for that property.

Mr. SWACKHAMER. It is the concept used by every business in this Nation.

Mr. COLEMAN. It may be true, but I mean, when we're talking about what our responsibility is and how much money you're asking for and all of these other things is very important that we recognize that that blue is evaporating, and that blue is basically what you're asking us to fulfill. You're asking us to basically take up that slack, are you not?

Mr. SWACKHAMER. We're asking the assistance of the Federal Government for financial support so that we can absorb that shock both to the agricultural sector and financial markets to mitigate and dampen the severe impact that it will have.

Mr. COLEMAN. So, that the net worth—going back now to my original statement to Mr. Roll's original statement—that the so-called net worth that backs up these bonds that you pledged is basically not much in 2 years.

Mr. SWACKHAMER. In 2 years we——

Mr. COLEMAN. In 2 years, net worth wouldn't matter if you were a bondholder. Right?

Mr. SWACKHAMER. In 2 years we project the net worth would be 0.4 compared to 5.1 today.

Mr. COLEMAN. Right.

Mr. SWACKHAMER. Without Government assistance.

Mr. COLEMAN. So that your pledge to the bondholders could be fulfilled with 0.4. They wouldn't be very happy, but your pledge would be fulfilled, would it not?

Mr. SWACKHAMER. No; our pledge goes deeper than that.

Mr. COLEMAN. All right.

Mr. SWACKHAMER. Our pledge incorporates all of those risks.

Mr. COLEMAN. All right. Including the stockholder paid in.

Mr. SWACKHAMER. Including the stockholder——

Mr. COLEMAN. All right.

Mr. SWACKHAMER. In other words, the bondholder expects to look to surplus loan losses and stockholder interests before he is——

Mr. COLEMAN. Now, there is about $5 billion held by farmer stockholders. Right?

Mr. SWACKHAMER. Correct.

Mr. COLEMAN. And what is the average holding by a farmer stockholder?

Mr. SWACKHAMER. That depends upon the size of the loan. It's generally proportional to the loan and may be anywhere between 5 and 10 percent by statute of the loan balance or loan amount outstanding at the time the loan was made.

Mr. COLEMAN. So what's your average loan with the borrower?

Mr. SWACKHAMER. It depends again by the type of credit. Cooperatives as farm businesses, processing, marketing, and otherwise serving are very large loans. Rural homeowners and small part-time farmers would be rather small loans. Operating loans might be as small as for the purchase of a pickup truck. A farm loan in large agricultural areas of the Midwest is going to be larger than in the East.

Mr. **Coleman**. OK. Well, we're all concerned about the farmer borrower and his equity and his stock. And I would like to have you tell us what we're talking about as far as how much exposure that person has out there.

Mr. **Swackhamer**. That person's exposure is total loss.

Mr. **Coleman**. And I would like to know what that is to the average farm borrower. I know what it means to the whole system.

Mr. **Swackhamer**. Well, divide the total by 1 million borrowers.

Mr. **Coleman**. So you've got $1 billion divided by 1 million. What's that?

Mr. **Tucker**. $66,000?

Mr. **Swackhamer**. No, it's the total of the risk funds divided by the total number of borrowers if you want an average but—

Mr. **Coleman**. What is that?

Mr. **Swackhamer**. I would have to divide it out.

Mr. **Coleman**. $7 billion divided by $1 million?

Mr. **Swackhamer**. Something like that.

Mr. **Coleman**. Is that $7,000? So the risk to the average borrower is $7,000 of, let's say, a stock that he bought that went out.

Mr. **Swackhamer**. Of course, you have to recognize at that point he has lost a lot more.

Mr. **Coleman**. Well, I am just talking about his stock.

Mr. **Swackhamer**. That would be the stock exposure.

Mr. **Coleman**. All right.

Mr. Roll, if I might have one more question? The people that you deal with that buy your securities, aren't these pretty sophisticated individuals?

Mr. **Roll**. They are.

Mr. **Coleman**. And yet they have made these purchases based upon what you have characterized as a perception?

Mr. **Roll**. That is correct, and that extends far beyond the Farm Credit System. It extends into the Federal National Mortgage Association, the Federal home loan banks. All of the agencies' securities—"Sallie Mae"—are bought on the basis that these are Government-sponsored organizations and they are sophisticated, they do know they are not guaranteed nor are they Government obligations. But we have not sold on our credit at two basis points over treasuries in the past, even though we are a very strong financial organization.

There is a perception there which we do not promote. I mean, we very clearly say we are not Government guaranteed, but that perception does exist.

Mr. **Coleman**. Are the holders of your securities a matter of public record?

Mr. **Roll**. We do not have a record of the holders of our securities any more than the U.S. Treasury does, because we are sold in the same way and delivered in the same way. We're delivered through the Federal Reserve System on book entry, and we have no record of who owns our securities.

When we make a security sale, we do a survey of our dealers who tell us by class who buys our securities, and we do this from time to time so we know who our investors are by class.

But once our securities are delivered, they trade in the Federal Reserve wire system. We have no knowledge of who owns our securities in the secondary market.

Mr. **Swackhamer**. Mr. Coleman, may I respond further to your question? I think, beyond the perception there are several attributes of Farm Credit System securities as well as FNMA, Federal home loan bank securities, which constitute the terminology of agency status. That means that they are eligible for Federal Reserve purchase. Many other securities are not. They're eligible to be held for certain purposes in certain accounts by other lending institutions, and other securities are not.

So, I think there is more than a perception, clearly. Operationally there is in terms of statute and other relationships. I think there is more than a perception that our obligations to investors are in some way or other implied or implicitly backed by the U.S. Government.

Mr. **Coleman**. Well, I guess that's the whole question as to whether they are or will be.

I will go ahead and yield.

Mr. **Jones** of Tennessee. Thank you very much, Mr. Coleman.

Now I yield to Mr. Weaver.

Mr. **Weaver**. Thank you, Mr. Chairman.

Gentlemen, thank you for your testimony. As bankers, what is the first thing that the banker looks at in evaluating a new loan? Isn't it the ability to pay back, Mr. Swackhamer?

Mr. **Swackhamer**. Yes; as reflected in several things: The ongoing nature of the business, its profitability, markets that it's in, the history of the management—all summarized mean does it have the ability to repay the loan?

Mr. **Weaver**. Mr. Tucker, the ability to pay back is the key, isn't it, in evaluating a loan, as Mr. Swackhamer just said?

Mr. **Tucker**. That is correct, sir, and the reason that we're in the situation that we're in today is, because of the profitability in agriculture, we don't have the ability to pay back.

Mr. **Weaver**. Mr. Roll, ability to pay back is the key, isn't it, to a sound loan?

Mr. **Roll**. I would believe so, sir; yes.

Mr. **Weaver**. I see nothing, gentlemen, in your proposal that helps to raise farmer income, to help him pay back the loan. Nothing at all.

Why do you want us to throw good money after bad? The key is the ability to pay back and nothing in this proposal helps that.

Certainly, nothing in the farm bill that I know of that this committee—or not this committee, but the Agriculture Committee in the House and the Senate—excuse me, I am not supposed to mention that word—that we passed helps to raise farm income.

Would you tell me why we should put money in when the critical consideration has not been helped in any way?

Mr. **Swackhamer**. Mr. Weaver, as a creditor, it's difficult for us to directly affect the profitability of U.S. agriculture. But to the extent that agriculture is a capital-deficit industry, it's a very capital-intensive industry, it is a very necessary industry and very vital to this Nation's economy, an assured flow of reasonably priced credit is essential to the industry. And that has been our role.

Now, to the extent that we can make sound and constructive credit available on a sound basis, as you say, with the ability to repay, that by definition must presume that that business is operating successfully, generating a profit, and able to repay the loan. And we have many, many loans in that category.

Unfortunately, the nature of the industry is such that it is cyclical, it is in a downswing, and there are a few loans now rapidly accelerating in number that are pulling us and our good borrowers down.

Mr. **Weaver**. Mr. Swackhamer, I understand and agree with everything you said.

Mr. **Swackhamer**. Thank you.

Mr. **Weaver**. But we haven't bailed out the Farm Credit System yet, and I noted from somebody's testimony that loan volumes dropped $6 billion this year already. Is that correct?

Mr. **Swackhamer**. Approximately so. Through September 30———

Mr. **Weaver**. Well, loan volumes dropped $6 billion. So I don't see how Government helping of the Farm Credit System is going to increase your loan volume, which you just said was the critical point that you had to do to make more loans, that's how you're going to help the farmer. Farm loans are falling in your system, $6 billion.

But we have not addressed the ability to pay back. I can only tell my dear friend—and let me tell you, I think he is the finest Member of the Congress of the United States, the chairman of this subcommittee, Congressman Jones—I include Congressman Glickman in that as well. [Laughter.]

Mr. **Glickman**. And Mr. Gunderson, too? And Mr. Coleman as well, also. [Laughter.]

Mr. **Weaver**. Everyone present. [Laughter.]

Mr. **Coleman**. Give the gentleman 5 additional minutes. [Laughter.]

Mr. **Glickman**. Not on my time. [Laughter.]

Mr. **Swackhamer**. Mr. Weaver, perhaps———

Mr. **Weaver**. But let me just finish that. I would be delighted, if I have any time left, to have you respond.

I am just simply going to say that until the farmer is given the means to pay back these loans, I cannot vote for any provision of any bill and the bill itself that contains money going into the credit system.

And I am going to challenge the administration to put into a farm bill something that helps give the farmers the price rise of their goods and the rise in income that will help them pay the banks and the Farm Credit System back so that your system is once again solvent and credible.

But the administration promised a veto of the only provision in the farm bill that would have raised farm income without, by the way, any cost to the Federal Treasury, which was to allow farmers to control their supply.

So, I am just simply saying, not 1 penny at least will this member vote so long as the farmers are deprived of their ability to raise their own income.

Mr. Chairman, if the witnesses have something to say, I am concluded.

Mr. Jones of Tennessee. Thank you very much, Mr. Weaver.

Mr. Swackhamer. Mr. Jones, I might respond further. I think there is something you can do. The profitability of a farm business is derived not only by the product it sells, but also by the costs of its operations. The cost of interest to U.S. agriculture is its highest cost of a purchased input. And absent the Farm Credit System or financial assistance to the Farm Credit System, the interest costs of U.S. agriculture can only rise, and it's rising rapidly now through us because of the uncertainty in the financial markets.

You can make a contribution to assist the profitability of farm businesses by helping us, and, in turn, we help U.S. farmers who borrow from us.

Mr. Jones of Tennessee. Thank you very much, Mr. Weaver, and the panel, for your discussion.

Now the Chair yields to Mr. Gunderson 5 minutes.

Mr. Gunderson. Thank you, Mr. Chairman, and witnesses.

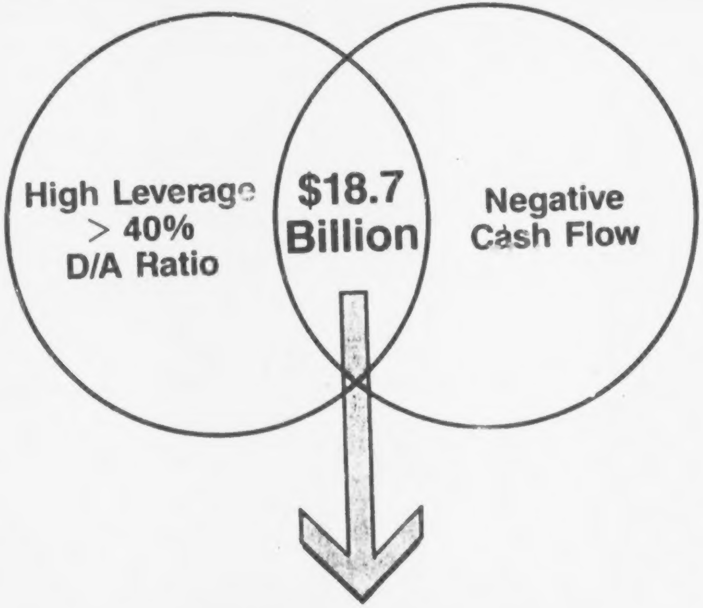
I would appreciate if you could elaborate for me and for the subcommittee how you have projected or how you have arrived at your projections. You refer to the Chase Econometrics study. I assume you've done some of your own. I am interested in how you project, one, what your losses are, what you project your nonperforming loans are going to be, what your projected need is in terms of Federal assistance.

I look at your numbers, and I am wondering, are they a positive estimate, are they a conservative estimate? Are they best-case, worst-case scenario? Are you basing them on the present farm legislation? Are you basing them on the new farm bill? Any idea how all these are arrived at would be helpful.

Mr. Swackhamer. Mr. Gunderson, I would like to show you a couple of charts, I think, that help show the picture.

[The charts follow:]

FLB/PCA FARM OPERATOR LOANS— HIGH LEVERAGE/NEGATIVE CASH FLOW



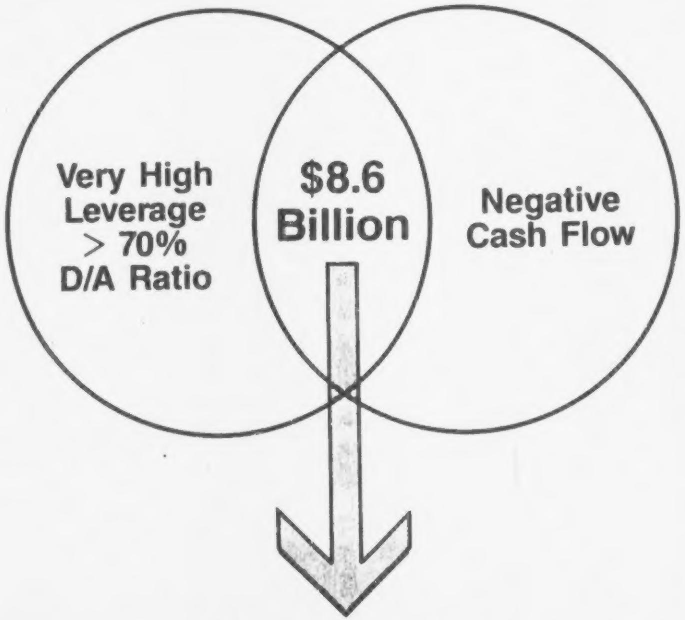
High Leverage
> 40%
D/A Ratio

$18.7
Billion

Negative
Cash Flow

- 26% of FLB/PCA Borrowers
- 45% of Farm Operator Debt Outstanding

FLB/PCA FARM OPERATOR LOANS— HIGH LEVERAGE/NEGATIVE CASH FLOW



Very High Leverage > 70% D/A Ratio

$8.6 Billion

Negative Cash Flow

- 10% of FLB/PCA Borrowers
- 20.5% of Farm Operator Debt Outstanding

Mr. **Swackhamer**. The first one shows that as of January 1, 1985, the U.S. Department of Agriculture survey of farmer cost and returns reveal that the Farm Credit System held in its portfolio $18.7 billion—that's the amount that connects the two circles, high debt-to-asset ratio on the left and negative cash-flow on the right.

Now, that is the amount of what would normally be considered very highly leveraged credit by commercial business standards.

Now let's go to the next chart showing a further breakdown of that amount, which is even more at risk for both the borrower and the lender.

Of that $18.7 billion, an additional $8.6 billion was in a category with debt-to-asset ratio greater than 70 percent and negative cash-flow. And as both the Farm Credit Administration testified and I have testified, $3.5 billion of that amount represented loans to borrowers who had loan balances outstanding or debt outstanding that exceeded the total value of their assets. That was on January 1, 1985. This we have called a "macro look," from the Department of Agriculture, setting an upward bound.

We have, in addition, undertaken during the past year a financial stress study of our PCA's, a credit review of the Federal land banks, and we have tried to analyze the quality of our loan portfolio. And to that extent, we have concluded that there is out of these numbers $13 billion of nonaccrual loans that we must process.

We will have $6 billion of that amount by yearend. We will probably peak at $11 billion somewhere late in 1986. And out of that amount of $13 billion, $3 billion of it we are going to probably have to assume by yearend as losses, meaning the farmers will have been unable to repay. That leaves a balance of $10 billion of nonaccrual loans that have to be carried through this adjustment in agriculture, and that's why our proposal is based upon the "cost of carry" of $10 billion of nonearning assets. If you assume an interest rate of 10 percent, that is $1 billion per year on the $10 billion. We add to that the cost of operating, the processing of loans through the Capital Corporation, and we derive at a number that we need somewhere between $1.5 billion, which is the cost of carrying that $10 billion through an orderly liquidation. That's why our proposal uses a number greater than the Farm Credit Administration because that's the magnitude of the problem; it is greater.

Mr. **Gunderson**. Here's the concern I have. You're coming in today with a number of $6 billion; the Farm Credit Administration came in asking for $5 billion. In discussions that I've had with your system personnel and others I've heard numbers anywhere from $5 to $15 billion.

You're all coming in fairly low today, fairly conservative. My concern is—and one of the statements Mr. Tucker made in his testimony was, in the Louisville district they currently have 3,000 loans which are nonperforming, and there are upward of 11,000 additional loans which could be in trouble next year. But I use that only as an example because he's talking about a tripling potential, a tripling of the number of nonperforming loans. That's not unique to his district; my St. Paul district has the same kind of scenario, depending very much on what happens in the farm bill, et cetera, and I think it's just essential for this committee, when we decide what to do and how much, that we have some clear analysis of the predictions and the economic net farm income you're projecting over 1986 and 1987 which arrives at these projections.

Mr. SWACKHAMER. OK. A very reasonable question.

First of all, the study done by Chase Econometrics uses the administration's estimates of the economic position of the United States now and over the next 2 years, so that's the base that we have used. If it's right, it's very right; if it's not, it's not, but it's the best that's available from the administration and that's what we have used.

We are talking two concepts, though, and it's important that you understand the two concepts. If we have $10 billion of loans for which borrowers cannot repay, one way of helping us is to purchase the $10 billion. But we have concluded that the budget impact of the Capital Corporation being funded to purchase $10 billion of nonaccrual assets is just too great in this environment, and with budget deficits and facing a Gramm-Rudman attempt to try to curtail further deficits.

What we have concluded is that it's a much better fiscal decision to provide a supplement as a cost of carry for those $10 billion on an annual basis than to try to purchase them. So, that forces us, as lenders, to take an additional write-down as we move the loans over for the cost of carry. We can't really avoid that; that is a part of our responsibility, and we're willing to accept it. But we still need some way or other to generate the income to retire the debt that has already been sold to fund those loans which farmers cannot repay.

So, the two concepts—$10 billion, direct infusion to purchase, or provide the cost of carry and the cost of operating and liquidating, which seems to us to be a fiscally more responsible approach, and that's why we came with it.

Mr. GUNDERSON. Thank you.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Gunderson. Now the Chair yields to Mr. Glickman.

Mr. GLICKMAN. Mr. Roll, I think we've got to make it clear that your securities are clearly marketed with the stamp of the Federal Government on them. They're called Federal farm credit securities; and notwithstanding any attempts to try to say that the Federal Government is not an explicit guarantor of those securities, which most sophisticated investors know, you don't have any doubt that people would be buying the securities at roughly the same interest rate that they could get from U.S. Treasury securities unless they believed that they were directly or indirectly backed by the U.S. Government. Isn't that correct?

Mr. ROLL. I have no doubt about that.

Mr. GLICKMAN. And I think that, for the purposes of those people who somehow relate this issue to bailing out private banks, they ought to realize that as far as I'm concerned we're talking about Federal securities here. And people have bought them as Federal securities for a long time, and that if we—notwithstanding our attempts to make you suffer a bit in this process—but if we don't think that these are Federal securities, I agree with you; I think every other security issued by the U.S. Government, including the

Treasury bills that we will issue if we ever get this debt ceiling issue behind us, would be jeopardized, and the ability of the United States to function as a nation, paying its bills and pursuing its obligations, is clearly jeopardized.

So, I believe that what we're talking about here are essentially U.S. securities. Now, given that, we have our options to provide some sort of a package that—excuse me—given that, we have our options to either not do anything, or else make you suffer as part of the package, or else provide just a full ad hoc, upfront bailout with no strings attached. And I think it would be devastating for this Government and for farmers and for people who rely on our ability to operate as an entity to escape the fact that we're talking about Continental Illinois Bank here, or we're talking about Citibank here; we're not. We're talking about, basically, the U.S. Government, an entity of which, if it can't get its act straightened out, is going to go down the tubes. And I think that's the perspective we ought to talk about.

Now, given that, you indicate that you will support legislation which will provide enhanced regulatory powers for the Farm Credit Administration. Is that correct?

Mr. SWACKHAMER. Yes, sir; that is correct.

Mr. GLICKMAN. OK. But then you say, "coupled with the withdrawal of the agency from participation in management and business policy determinations of system institutions." So, effectively—what I just said before is that—I've basically said that the Farm Credit System is essentially a Government entity. Now, if you're a Government entity, can you have it both ways? Can you have the Federal Government regulating you only partially but not regulating you completely? What kind of role are you going to have vis-a-vis the Federal Government?

Mr. SWACKHAMER. I think the answer to your question, Mr. Glickman, is that in the past, with the origin of the Farm Credit System, the Farm Credit Administration played a far greater operational role than is appropriate for it today. Therefore, when the 1971 Farm Credit Act was produced, it was a condensation and a codification of a lot of other statutes and it retained a strong operational role for the regulatory agency. It required their prior approval on the interest rates we set; it requires their prior approval on the distribution of the income, all appropriate fiduciary responsibilities for a board of directors. So, what we're now proposing is, we will accept a strong, a forceful regulator, but we think it's also incompatible that a strong and forceful regulator would make the operating decisions, prescribe the policies for the operations of the banks, and do everything else. You don't have a strong regulator and an operator; you have one or the other.

Mr. GLICKMAN. OK. Now, the problem is—and while I may agree with you conceptually—the problem is that what you want is a little bit of a relationship between you and your regulator, like the banks have with the FDIC.

Mr. SWACKHAMER. That is what we said we will support.

Mr. GLICKMAN. OK. But on the other hand, if you deem your securities to be Federal securities, you are a different institution than banks are, aren't you? You're more of an instrumentality of the Government of the United States.

Mr. SWACKHAMER. That is the way we are chartered.

Mr. GLICKMAN. So, therefore, all of the analogies between the banking system are not necessarily parallel to the way you operate, then. I just think we're going to have to look very carefully at how we're going to structure your relationship with the Farm Credit Administration.

Now, I want to know how long you can wait. One of your statements indicated that at least 40 PCA's will be liquidated within a few months. How long can you wait without any help from this Government in the form of a line of credit or in the form of other monetary assistance before these disastrous consequences begin happening?

Mr. SWACKHAMER. Well, I think there are two answers, and then I might ask my colleagues to respond.

We identified that we have potentially two crises. The first and foremost is probably the financial markets, where we can be shut down and closed out very quickly. We have been experiencing, in fact, some difficulty; we have canceled term bond offerings. We have postponed others. We have ceased offering 9-month——

Mr. GLICKMAN. Did you have a sale this week?

Mr. SWACKHAMER. We have a pricing today.

Mr. GLICKMAN. Do you have any idea what your basis point spread is on that?

Mr. SWACKHAMER. I'd ask Mr. Roll to respond to that.

Mr. ROLL. I have not talked to the office this morning; I've been here all morning, but we were expecting the basis point spread to be somewhere—100 to 105 or 110 basis points. I don't know; it's being priced almost right now.

Mr. GLICKMAN. That's over Treasury?

Mr. ROLL. That's over Treasury.

Mr. GLICKMAN. Is that the highest it's been?

Mr. ROLL. That would be the highest it's been in that particular maturity range.

Mr. GLICKMAN. OK. Now go on back to the immediacy of your crisis.

Mr. SWACKHAMER. The point is that the financial markets can precipitate it quickly, causing us to operate on our liquidity which, I think Mr. Roll said, was approximately 18 days' worth of operation. At that point, then, something would have to happen.

Mr. GLICKMAN. Yes; but that point means a trigger where you couldn't get any financing. Now, assume you get your financing today and you sell more bonds today, that——

Mr. SWACKHAMER. Then we would have to start liquidating loans to repay obligations borrowed.

Mr. GLICKMAN. OK. Continue on.

Mr. SWACKHAMER. That's likely to be the first and most serious—precipitous—event that could happen in the near future. But beyond that, the problem also is in the agricultural sector where we have a confidence crisis, and that means that the capital that Mr. Coleman was searching for is not permanent capital. It can flee and it can move out; and what it leaves, then, is a disastrous situation for the borrowers who don't have that opportunity, and there are many relatively small cooperatives and many relatively small farmers who just don't have a good alternative, given the financial environment they find themselves in.

So, we have two potential crises, either one of which can be very devastating.

Mr. GLICKMAN. Now, just one final question if I might, Mr. Chairman.

What would happen if we did not pass any legislation providing an input of funds by the end of the year?

Mr. SWACKHAMER. I think then we, and you in Congress, and the borrowers of the Farm Credit System would face, as the Farm Credit Administration has said to us, further liquidation of associations or consolidations, merger; potentially, then, the liquidating of farm credit banks. We will have to use the resources that we have to the extent available in the absence of any financial assistance, but doing so, we cannot decrease interest rates and we cannot extend forebearance for distressed farmers who really need additional time.

Mr. GLICKMAN. I would just say, Mr. Chairman, just finally, I do think that the Chrysler Corp. and New York City bailouts offer a lot of parallels to what we're dealing with right here. Both instrumentalities, private and public, made mistakes in what they had done before; but had the Government not stepped in in those two respective cases in requiring both self-help as well as Government assistance, it would have been very serious for this country. And I think the same thing is true with respect to you all.

Mr. SWACKHAMER. And not unlike those solutions, we, too, have made the commitment that we will accept the obligation to repay both the principal and interest of any borrowing from the U.S. Treasury through the revolving funds of the Farm Credit Administration as long as the conditions permit us to do that over a reasonable period of time.

Mr. GLICKMAN. And like both situations, you, too, will have to relinquish some of the absolute and total control you've had over your operations and your ability to manage your institutions during that period of time, as well.

Mr. SWACKHAMER. That is the part of the pain that we're willing to accept.

Mr. TUCKER. If I might add one comment to this, we need to talk about the farmer aspect of the problem. We carry the cost presently of these nonaccrual loans; that's increasing the cost to the farmer with a higher interest rate, and I think that point needs to be made.

Mr. GLICKMAN. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Glickman, for your questions.

And now to Mr. Evans for 5 minutes of questions.

Mr. EVANS of Iowa. Thank you, Mr. Chairman.

I have here a research paper done by one of the bond advisory services dated October 8 that is, I think, rather widely read, and the bottomline of its recommendation is, "We view farm credit debt as an attractive acquisition at current prices." Is that an exception, or is that rather generally being presented by some of the advisory services at the present time?

Mr. **Roll**. Several of the advisory services have made recommendations that, because the wider spreads and the higher rate, that it is attractive, and that is the new buyer that we have attracted; and that buyer is the buyer that is willing to accept risk for a price based upon his beliefs that the Federal Government will ultimately stand behind these. So, that effect is in the market right now. That's well understood out there on the streets at the present time.

Mr. **Evans** of Iowa. How many new dollars do you borrow today for every old dollar you're paying off? What's that ratio, roughly? Can you give me an idea of that?

Mr. **Roll**. Well, we're in a pay-down situation today.

Mr. **Evans** of Iowa. I understand you are, yes. Is it $0.90 on the dollar, or——

Mr. **Roll**. Well, we've paid down, in the first 6 months—we've paid down about 6 billion dollars' worth of debt, I think, so we've rolled over so far this year $60 billion. So we've paid down $6 billion out of $60 billion. We've rolled over $60 billion.

Mr. **Evans** of Iowa. All right. That answers my question.

Going on to the line of credit, would that be on-budget or off-budget the way you people are thinking about it?

Mr. **Swackhamer**. There's a possibility that it might be handled either way.

Mr. **Evans** of Iowa. I would imagine that the administration would have definite preferences on that.

Mr. **Swackhamer**. Yes; I think they do.

The Treasury has certain authorities under the Second Liberty Bond Act, perhaps, to do financing, and I'm not that familiar with what those are——

Mr. **Evans** of Iowa. But it might be possible to make deposits into a revolving fund for the benefit of the Farm Credit System that would not impact the deficit, at least immediately; is that right?

Mr. **Swackhamer**. Again, you're getting into a budgetary area where we lack the authority to respond effectively to your question. But I think there are alternatives, Mr. Evans.

Mr. **Evans** of Iowa. Moving to stock and the matter of its impairment, and your chart that you had up there a while ago that showed roughly $5 to $6 billion in stock-type capital, were you differentiating between bank stock and association stock? And if so, to what extent?

Regardless of the answer to that question, really what I'm getting at, what fraction of that $5 billion, shall we say, is actually paid for as opposed to being debt obligations of stockholders? It's pretty hard to bring to bear on a problem capital that is only debt that is owed. Any comments on that?

Mr. **Swackhamer**. If you're referring to the $4.9 billion that shows on the far right side——

Mr. **Evans** of Iowa. Yes.

Mr. **Swackhamer** [continuing]. We do have the authority to advance, as a part of the loan, money to the borrower to purchase stock. However, the stock purchase is at risk and the borrower must accept that. Now, I do not know what percent that might be, but the obligation of the borrower is to first pay the stock, so we consider that to be good risk funds in the collection of any loan.

Mr. Evans of Iowa. I'm not sure I understand your answer, but——

Mr. Swackhamer. Well, if your question is, Is it available to support the net worth of the institution, the answer is "Yes." If your question is, Is it a further burden on an already burdened farmer who may be delinquent, the answer is also "Yes."

Mr. Evans of Iowa. Especially if he hasn't paid for the stock yet?

Mr. Swackhamer. Well, his obligation is to pay for the stock, and it's collected out of liquidation of the collateral if he fails to pay otherwise.

Mr. Evans of Iowa. All right.

I was very much interested in your description of how the Capital Corporation would function, and I thought that was extremely enlightening. I would like to go back, if I may, to the relationship between the funding corporation and the Capital Corporation. What sort of a relationship would exist there? Do you make borrowed funds available to that corporation? Do you loan it to them?

Mr. Roll. At the present time, we do not.

Mr. Evans of Iowa. But will you?

Mr. Roll. At the present—and that would depend on the final design of the system as to whether that organization were to become consolidated as a part of the 37-bank obligation. It is possible that it could happen in the final design of that plan.

Mr. Evans of Iowa. But taking funds raised on Wall Street to provide funds to the Capital Corporation is not a principal way of getting money into the Capital Corporation, is it, under your concept at the present time?

Mr. Roll. No; no.

Mr. Evans of Iowa. Thank you.

Mr. Jones of Tennessee. Thank you very much, Mr. Evans.

Mr. Stenholm, are you ready? No questions?

Panel, I have a question or two I'd like to refer to you.

This morning we heard a great deal—I guess all three of you were here this morning, too—you heard a great deal of criticism aimed at Governor Wilkinson's statement regarding the Farm Credit System's relationship with its borrowers. And really, I felt like since he's in a regulatory position, some of these questions should be directed to you of the council rather than those that were directed to him. And I think it's only fair, now, to ask you to respond to some of the issues raised earlier with the Government, such as—you heard criticism about interest rates, about foreclosures, about accounting standards, lending practices, and I'd just like for you to dwell on those, as an illustration, for a few moments if you don't mind. Any of the three of you.

Mr. Swackhamer. OK. Well, let me take 1 brief second to make one point.

We are a financial intermediary, chartered to service the agricultural sector. About 95 percent of all of our costs are the costs of money. We can squeeze, we can sacrifice, we can do other things, but we still fundamentally have to face the fact that the cost to the borrower, his interest rate, is basically the cost of money that we buy.

Now, we extend that credit to him for whatever amount it takes to operate the organization to get it to whatever that borrower is, and that's basically the only other cost, other than necessary reserves and surplus that need to be maintained in a prudent fashion. That's what determines the cost of credit to a borrower, Mr. Jones, and it's influenced far more by monetary policy and national economic conditions than anything we can do.

Mr. TUCKER. Mr. Jones, if I might just briefly respond to that. So many things that affect how we operate, because we're only lenders to agriculture—that's our sole source that we lend to—we are so very much dependent not only on our borrowers and their ability to repay and profitability in agriculture. We know economic and weather conditions and many of those other things affect us, both locally, and sometimes, nationwide. Also, we've been hit, because of that profitability in agriculture, in some areas—in many areas around this country—in seeing our land values drop in some areas by as much as 50 percent or more, and in some areas we have seen a rise. But that is not something that prevails throughout the country today. And this is one thing that's helping determine the strengths of those three banks that at this time are in an uncomfortable situation.

As I pointed out earlier in my testimony, as I appeared before the Agriculture Committee in the spring when they were discussing the farm bill, one of the things—speaking from a credit standpoint—I said that we needed to return was profitability in agriculture; and we, as the Farm Credit System, need to be aware and help support that. As far as the design that needs to be, we don't feel that we can do that because of the many commodity groups that are involved in that.

Mr. ROLL. With respect to the accounting that we have, we are extremely concerned about the credibility of our financial reporting. This has come into question. We are working very, very diligently to present our financial statements on the basis that they are fair, to disclose our financial information on a timely manner, and that is the involvement of—the firm of Price-Waterhouse & Co. has been brought in to help us in that area and to assist us by issuing a certification at the end of this year, and I'd like to reiterate that I'm convinced that the banks will take whatever action is necessary to earn an unqualified opinion.

Mr. JONES of Tennessee. Thank you very much, gentlemen.

Anyone else on the panel have questions?

Mr. COLEMAN. Mr. Chairman, I'm wondering if Mr. Swackhamer, who had the charts—I think he had some in printed form—would supply those to us right now, or as soon as possible. I think they would be helpful to visualize the problem.

Mr. SWACKHAMER. We'd be very happy to supply the staff of the subcommittee with charts for all the members.

Mr. JONES of Tennessee. Very good, Mr. Swackhamer.

Mr. WEAVER. Mr. Chairman, might I just say to my good friend from Kansas who said that by appending the word Federal onto the Farm Credit Administration that it made it tantamount to a U.S. Government agency, that he must therefore say that Federal Express is the U.S. Post Office? [Laughter.]

Mr. GLICKMAN. I disagree with the gentleman's characterization. Federal Express has not been selling its securities under the guise that it is an agency of the U.S. Government.

Mr. JONES of Tennessee. Thank you very much, gentlemen, for being here and we do appreciate your kindness and attentiveness in the questions that have been directed to you.

Mr. SWACKHAMER. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, and we appreciate that opportunity.

We're going to put together the next three witnesses as a panel also. The Honorable Frank Naylor will not be here until tomorrow. We will go to Mr. Alan Tubbs, chairman, Agricultural Bankers Division, American Bankers Association; Mr. Bud Gerhart, chairman, Agriculture Committee of the Independent Bankers Association of America; and Mr. Frank Smeal, partner and member of the Management Committee of Goldman Sachs & Co., New York.

Gentlemen, if you'll all come to the witness table collectively, we'll hear all of you as you sit there together. That will expedite the panel's ability to spend more time asking questions.

Gentlemen, we do appreciate very much your being here. Mr. Tubbs, you may proceed.

STATEMENT OF ALAN TUBBS, IMMEDIATE PAST CHAIRMAN, EXECUTIVE COMMITTEE, AGRICULTURAL BANKERS DIVISION, AMERICAN BANKERS ASSOCIATION

Mr. TUBBS. Thank you, Mr. Chairman, and members of the subcommittee.

I am Alan Tubbs, president of First Central State Bank in eastern Iowa. I am representing the American Bankers Association as immediate past chairman of the Agricultural Division of that group.

Combined assets of our nearly 13,000 member banks represent approximately 95 percent of the industry total. While our members range in size from the smallest to the largest banks, approximately 85 percent of them have assets of less than $100 million. Half of those, or better, are rural banks.

Mr. Chairman, farmers, agricultural banks, and the Farm Credit System all are facing the same deteriorating agricultural economy.

Economic problems of a size not seen by generations of Americans are wrenching farm life and rural communities across this country. Evidence is mounting that fear and despair are spreading among hundreds of thousands of farmers who are looking at millions of acres of farms likely to fall into the hands of creditors. And I might add that an attitude of loss of hope is perhaps the most frightening thing that is occurring on the rural scene.

The interest on the farm debt now totals more than $21 billion a year, and net farm income is projected to drop by 28 percent from 1984 to 1985, to the $25 billion range. Further, this economic data cannot convey the personal signs of the severity of the problem that have been evident over the past few months in visits with my own farm customers, with other bankers, and with agribusiness people in rural communities.

Let me assure the subcommittee that the ABA does recognize the severity of the problems facing the Farm Credit System. We empathize because agricultural bankers face exactly the same problems:

declining farm income and asset devaluations are the key underlying causes of the problems that we're experiencing.

We recognize that the basis of the farm financial problem is declining income, and that we're at the end of the rope as far as credit being substituted for income.

The ABA supports the survival of the Farm Credit System because our survival is tied to that system as well, and we recognize that Federal assistance will likely be necessary. But we urge this subcommittee to view the agricultural credit situation and the Farm Credit System's proposals for assistance from two perspectives. First, the survival of the system is a short-term goal of both the system and agricultural bankers.

Second, however, any congressional response to this short-term goal has long-term implications for the role of the Farm Credit System in relation to the commercial banking system and the structure and competition for agricultural financing in the future. These implications for the future cannot be ignored.

The ABA has testified before this committee numerous times to object to an ever-broadened mandate for this cooperative financial institution. ABA testified four times before the House and the Senate during the hearings on the system's proposals for expanded authority in 1979 and 1980. We also expressed our concern about the lax regulation by an agency, the Farm Credit Administration, that was not independent of the banks themselves. During a markup of the Farm Credit Act Amendments of 1980, members of the House Agriculture Committee noted their concerns about the liberalizing amendments that were passed, but they were passed. And while barriers to commercial bank access, to agency funds were to be lowered at that time, the fact is that those barriers were, in fact, tightened at that time.

With the paucity of real estate funds available in today's market, banks and other lenders need access to funds to support our current depressed real estate market. Following the passing of those amendments, the Farm Credit System then began a major study of its future, its structure, and its role in agricultural finance, titled Project 1995.

Today, the Congress is faced with a very difficult situation concerning this same Farm Credit System. The system is requesting a major assistance package and implying that if assistance is not approved within a very short time, that total collapse may be imminent. From one perspective, this is obviously the worst time to raise questions about the role of the Farm Credit System in the future; but from another perspective, it is precisely the time at which this question must be asked.

If the Congress does not consider the role that it wishes the Farm Credit System to play in agricultural lending in the future as it develops this assistance package, it will be confirming, by default, the role which the Farm Credit System has chosen for itself and outlined in Project 1995.

The system is developing that role, and it is becoming much more centralized. Over time, if assisted without limitations—if, in effect, rewarded for its difficulty—it will become aggressive again.

Private agricultural banks welcome competition, but it must be fair competition. Competition from a federally assisted nonbank

bank seeking to offer additional services while retaining special access to the credit markets will not provide a competitive credit market for future farm borrowers.

As this subcommittee certainly knows, there is considerable objection to many current Farm Credit System policies. I am alluding to the consolidation of offices, to the decentralization of control, and to the foreclosure and liquidation standards that are apparent in the rural areas from which I am familiar. Based on this argument, these actions are not consistent with a cooperative enterprise controlled by farmer borrowers at the local level. If Congress determines that the direction in which the system is now going does not fit the role deemed appropriate for a cooperative agricultural lender, then changes in limits should be applied to any legislation providing short-term assistance for the system.

The ABA has developed criteria for the evaluation of farm credit legislation. I shall present these criteria and discuss them briefly.

First, a strong, independent regulatory agency must be established for the Farm Credit System. The ABA strongly supports the development of an FDIC-like agency for the regulation of the Farm Credit System. Our primary concern is that the regulatory agency be independent; simply giving additional authority and power to the FCA is not sufficient. The FCA must be made independent with an independent board and no management responsibility for the system banks.

Second, independent audits of the Farm Credit System and its components must be required. Independent audits are an absolutely fundamental requirement, in our opinion, for any financial institution, but particularly for one that is directly overseen by the U.S. Congress.

Third, the Farm Credit System's capital requirements must be carefully defined and made comparable to those of other major financial intermediaries. One of the major questions raised concerning assistance packages designed for the Farm Credit System is, what is the extent of its capital and in what form is that capital to be held.

Fourth, the Farm Credit System's internal practices assuring soundness must be made more stringent and more consistent from one district to the next.

Fifth, proposals for a short-term response to the deteriorating agricultural credit situation should not confer long-term competitive advantages on the Farm Credit System vis-a-vis the commercial banks. Providing assistance only to the Farm Credit System confers a long-term competitive advantage on the system by definition. The ABA believes strongly that a system that is today a major competitor to the private sector, and which wishes to strengthen its competitive position in the future while still maintaining the benefits of a cooperative, quasi-governmental financial institution, must be carefully examined by Congress. Any short-term assistance packages must be targeted and limited.

Sixth, any assistance package must provide equality of treatment for agricultural borrowers. The ABA objects to any short-term response to the deteriorating agricultural credit situation which would disadvantage borrowers at commercial banks relative to borrowers of the Farm Credit System. We strongly believe that agricultural borrowers from other institutions should have the same opportunities as borrowers from the Farm Credit System. All farm borrowers and all farm lenders should be treated equally in any assistance package.

Now I want to move on to the second major point, and that relates to asset stability. If we don't address this underlying element of the problem, that is the declining asset values, then any restructuring of the Farm Credit System or any assistance to the Farm Credit System or the banks will not be adequate. Ideally, future income prospects would arrest declining asset values; however, future income prospects do not appear to provide any support at all. Because real estate constitutes 75 percent of total assets, changes in the value of farmland will dominate changes in the asset side of the balance sheet as well as the net worth of farm borrowers. Farm sector assets have been decreasing since January 1981. Most recent USDA figures show that Iowa farmland values have declined 49 percent since 1981. All of this data tends to be lagged.

Let me bring you up to date. It is common today to experience real estate value declines in the range of 60 to 70 percent from peak values, and in my estimation, that would mean capital losses in Iowa in the magnitude of $50 to $60 billion, and I think our estimate this morning nationally was conservative; I think it's probably closer to a total capital loss of a quarter of a trillion dollars.

[The prepared statement of Mr. Tubbs appears at the conclusion of the hearing.]

Mr. **Weaver** [acting chairman]. Mr. Tubbs, thank you very much. I'm afraid that your 10 minutes is up. I believe that it's best now to recess briefly to vote; there is a vote on the MX missile by Mr. Frank on the floor of the House. If you'll excuse us, please, the Members will go vote. We'll be back as soon as possible.

I might say, we might solve the farm problem immediately by just simply classifying corn, wheat, and soybeans as MX's and give them money. [Laughter.]

Mr. **Tubbs**. Send them away.

Mr. **Morrison**. Mr. Chairman, we wouldn't be able to figure out where to plant them. [Laughter.]

[Short recess taken.]

Mr. **Weaver**. The subcommittee will be in order.

Mr. Tubbs, in fairness to the witnesses that are coming later—we're rapidly running out of time—I'm going to have to go on and ask Mr. Gerhart to commence his testimony.

STATEMENT OF BUD GERHART, CHAIRMAN, AGRICULTURE-RURAL COMMITTEE, INDEPENDENT BANKERS ASSOCIATION OF AMERICA

Mr. **Gerhart**. Mr. Chairman and members of the subcommittee, I am Bud Gerhart, chairman of the Agriculture-Rural Committee of the Independent Bankers Association of America and president of the First National Bank, Newman Grove, NE.

The IBAA is a national trade association representing about 7,500 local community banks, almost half of which are substantially committed to lending to crop farmers, ranchers, and other agricultural producers. Hundreds of those agricultural banks, including the one I'm with, have 75 percent or more of their total loans devoted to farm production.

The commercial banks are the largest suppliers of operating credit to farmers, with about $40 billion in production credit, more than all other non-Federal sources combined. This production financing is vital for debt servicing purposes, since farmers cannot service real estate debt, supplied mostly by the Farm Credit System, without adequate operating credit.

Farm loan losses are up substantially. With agricultural prices off 20 to 25 percent, virtually across the board compared to a year ago, agricultural banks will find it more difficult to finance many farm borrowers. With the mounting backlog of nonperforming loans, it will be even more difficult to finance farmers in 1986.

To deal with the problems of farm debt and financing, the IBAA has emphasized two basic considerations.

First, establishing the highest possible level of farm commodity price and income supports in the farm bill on a multiyear basis is the most critical step in preventing more farmers from sliding into insolvency. Attached to this statement is a copy of our letter sent to all Members of the Senate last week, recommending that, at a minimum, the farm income supports—target prices—must be maintained at existing levels for the next 4 years. Even this will not prevent the continued deterioration of the farm economy. Farmers must have adequate income to service debt. A farm program that improves prices and farm income will benefit farmers as well as lenders, and may be less costly than massive Federal assistance to lenders.

To achieve this, we believe that farmers should have the right to decide whether they want to use mandatory production controls, combined with higher price support loan levels, during this period of depressed prices and overproduction.

It seems logical to us, and fair, that farmers and ranchers whose survival is at stake be allowed a voice in this very vital issue.

Second, as various options are considered, it is very important that all lenders and their farm borrowers are treated equitably and accorded an equal opportunity to work their way out of the present difficulties.

Early in 1985, the Farm Credit System proposed an agricultural conservation corp. which would have the authority to purchase farmland and warehouse that land for a period of time until land prices stabilized.

In response, IBAA convened a group of agricultural bankers from 20 States here in Washington on September 22 to 24 to develop recommendations whereby agricultural banks and their farm borrowers could be provided equal access to any Federal assistance which might be forthcoming.

Specifically, we have recommended that any Federal assistance effort could be closely connected to an existing agency, the Farmers Home Administration, and might be limited to certain marginal changes in existing programs of the Farmers Home Administration. We proposed that such an agency could be authorized to purchase both farmland and farm loans. Loans could be subject to purchase at a discount, based on the value of the collateral securing the loan. The purpose of authorizing the agency to purchase either farmland or loans is to keep additional farmland, machinery, and other farm assets from coming onto already saturated markets and provide equitable treatment for both real estate and production lenders and their farm borrowers.

Over time, as farm asset values stabilized, this purchasing and warehousing agency could resell these farmland and loan assets. This would have the merit of directly benefiting farm borrowers by reducing principal and interest. A summary of these recommendations is attached to this statement.

The attached October 17 letter includes our response to the Farm Credit System's recent effort to secure major Federal assistance on a unilateral basis. We would consider it patently unfair for commercial agricultural banks to be permitted to continue to fail in record numbers—since the 1930's—and, at the same time, relieve the cooperative Farm Credit System of its loan losses through a direct and unilateral infusion of money at reduced rates from the Federal Treasury. Furthermore, such an approach would not solve the problem of individual farmers in getting affordable operating credit for production purposes. We would instead prefer putting any available Federal funds into higher price and income supports in the farm bill, pending the development of farm debt restructuring plans which are equitable to all farm lenders and their farm borrowers.

Other steps can be taken to relieve some of the financial stress. We have recommended that the direct lending programs of the Farmers Home Administration continue to be fully available to first-time borrowers. Farmers Home Administration's direct loan program will be vitally important in 1986, as it was in 1985.

A joint Federal-private lender interest rate buy-down program can be used to reduce the interest rate on certain farm loans. Each of these measures—guaranteed loans, interest rate buy-downs, and others—are equally available to farm credit banks and their borrowers, and to commercial agricultural banks and their borrowers.

In summary, we continue to believe that the price and income supports in the general farm bill are the best way to assist financially-stressed farmers, thus indirectly benefiting lenders. By taking some additional steps along the lines which we are recommending, and by considering other options, yet another tier of farmers might be prevented from slipping into insolvency. Keeping more of our farmer borrowers from getting into financial trouble has to be our goal.

We cannot emphasize too strongly the need for equitable treatment of agricultural banks and their farm borrowers, to keep that operating credit flowing and keep agricultural banks in a fully competitive and viable position.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Gerhart appears at the conclusion of the hearing.]

Mr. WEAVER. Mr. Gerhart, I didn't realize your testimony was so good. I'm going to ask you to repeat it when the Members come back—what I mean is, I didn't realize we agreed with each other so completely. [Laughter.]

I had anticipated Members being back by now, and I would like them to hear this testimony. Mr. Tubbs, why don't you finish your testimony?

REMARKS OF ALAN TUBBS

Mr. **Tubbs**. Thank you, Mr. Chairman. I had just completed talking about the tremendous decline in capital values of farm real estate, and suggesting that this decline has had a tremendous impact on banks. I think we now have 1,032 banks on the problem bank list nationally; it is expected to reach 1,300 by the end of the year. That's almost 10 percent of our Nation's banks. In Iowa, one-fourth of our banks are on the problem bank list. So it is not a problem that is isolated to the Farm Credit System.

We have examined proposals that would address the drastic decline and the domino impact on the farm asset values, and it appears to us there are three approaches that deserve consideration.

One approach is some type of a corporation or a warehouse mechanism, similar to what Mr. Gerhart was talking about, that would hold land off the market and stop this domino impact of these declining asset values. If some way can be found to emphasize the conservation aspects of this approach, to lease it back to capable operators or original borrowers and to keep them on the farm, then it would seem that this has merit. We are, of course, very concerned about the costs of that and the amount of land that might wind up in such an organization, but on the other hand, to do nothing might be more expensive in the long run.

The second possibility is a debt restructuring plan designed to lower a farmer's cash-flow. Agricultural bankers are willing to take part of the burden of restructuring debt in order to keep farmers on their farms and to keep land in the hands of the families. A proposal which would have the Federal Government, State government, or lenders participate in debt restructuring seems worthy of further discussion, and we'll be pleased to participate in those discussions.

A third option is some mechanism which would provide Federal backing which would allow the Farm Credit System and commercial banks to spread losses on agricultural loans out over a longer period of time. Such a mechanism would assist regulators as they examine these agricultural financing institutions. It should be carefully structured to provide time for lenders to practice forebearance with farmers so that both farmers and lenders have the opportunity to work out of their difficult financial circumstances.

Mr. **Weaver**. Mr. Tubbs, forgive me again. I see now why Members did not come back; we had another vote called immediately. I'm sorry, I'm going to have to recess the subcommittee and, I think, after this vote we should have the membership back.

[Recess taken.]

Mr. **Jones** of Tennessee. The subcommittee will resume its sitting.

Am I advised correctly that all three witnesses have given their testimony?

Mr. **Smeal**. I have not.

Mr. **Jones** of Tennessee. Mr. Smeal has not.

Well, Mr. Tubbs, did the acting chairman go back to you for some statement or something?

Mr. TUBBS. I've completed my formal testimony, thank you, Mr. Chairman.

Mr. JONES of Tennessee. OK.

Are you next, then, Mr. Smeal?

Mr. SMEAL. I assume so. Mr. Chairman, if you're going to cut me off after 12 minutes, I'm not going to read all of my testimony because I think there are some things this subcommittee ought to know——

Mr. JONES of Tennessee. I'll guarantee you that your prepared statement will be made a part of the record, Mr. Smeal, but you go as far as you need——

Mr. SMEAL. OK. What I need to do is read this and then editorialize the rest.

Mr. JONES of Tennessee. We've had splendid witnesses and still do, as far as that goes, but we're going to be pushed to accommodate all of them.

STATEMENT OF FRANK SMEAL, GENERAL PARTNER, FIXED INCOME DIVISION, AND MEMBER, MANAGEMENT COMMITTEE, GOLDMAN, SACHS & CO.

Mr. SMEAL. All right. I'll read the testimony and then, as I go along, I'll tell you things which I think have happened affecting the market for farm credit securities, which is why I'm here.

Mr. JONES of Tennessee. That would be very good.

Mr. SMEAL. I think it will be of general interest to the subcommittee.

My name is Frank Smeal. I am a general partner in charge of the fixed income division and a member of the management committee of Goldman, Sachs & Co., an investment banking firm with headquarters in New York City and offices across the United States and abroad.

I am pleased and honored to have this opportunity to testify about the market impact of recent reports of financial strains within the agricultural community in general, and the securities of the Federal Farm Credit System in particular.

Before I begin my testimony, I feel it is my duty to inform this subcommittee of the activities in which Goldman Sachs engages on a daily basis, both as a trader and as an investor, which could influence my remarks and observations. Goldman Sachs is a primary dealer in the U.S. Government and Federal agency securities. We make active and continuous two-way markets in all Treasury and Federal agency securities. In addition, we are a member of the dealer selling groups for new long-term agency issues whereby we assist in the distribution of these securities to the public. Goldman Sachs is also the only dealer firm which is a member of the selling groups for the short-term discount note programs of all Federal agencies and the World Bank. That fact will become more interesting as we go along.

On the investment side, Goldman Sachs operates a money market mutual fund known as Institutional Liquid Assets, or ILA, of which I am a trustee. This money fund has in the past been, and is presently, an investor in Federal agency securities, including those of the Federal farm credit banks.

Recent reports on the severe financial pressures currently being experienced by the Federal Farm Credit System have had a very definite and discernible impact on the market in farm credit securities, and to a lesser extent, on the markets in securities of other federally-sponsored agencies. This can be clearly seen by examining changes which have taken place in the yield relationships between farm credit and other agency securities, and U.S. Treasury securities with equivalent maturities.

Historically, the yield differences or spreads between Treasury and agency securities—which are typically quoted in basis points, or hundredths of a percentage point—have been small, stable, and reasonably predictable. This has been true because the securities of Federal agencies are generally viewed by fixed income market participants as possessing excellent credit quality because of the sponsorship of the U.S. Government.

Beginning in late July, the yield spreads between farm credit and Treasury securities widened beyond their traditional range. This increase in yield spreads, which can be seen in the chart before you on my left, occurred as the Farm Credit System disclosed its intention to assemble a financial aid package for the Omaha Intermediate Credit Bank. Over the next few weeks, as market concerns about the Farm Credit System's financial situation waned, these yield spreads gradually narrowed, although they did not return to their previously prevailing levels. On September 4, the Wall Street Journal published a front page article bearing the headline, "Out of Options: Farm Credit System Buried in Bad Loans, Seeks Big U.S. Bailout." The market in farm credit securities, which was still recovering from its earlier difficulties, came under intense new pressure; yield spreads between farm credit and Treasury issues soared, going from 16 to 64 basis points for issues with 6 months to maturity, and from 35 to 50 basis points on issues maturing in 5 years.

Incidentally, the low point at which—describing the yield spreads between farm credit and comparable U.S. Treasury securities—was sometime in August of this year, when farm credit issues sold at a negative spread; that is to say, they sold through at yields lower than the U.S. Government borrowing costs by 3 or 4 basis points. The high point occurred on September 26, when farm credit securities due in 6 months were 109 basis points, a better yield than comparable 6-month Treasury issues.

Since that time, yield spreads for farm credit securities have gradually, though erratically, widened further as periodic news items and investigative articles have served to keep the market's attention focused on the system's problems and the general problems of agriculture. By late last week, farm credit issues with maturities of 6 months, 2½ years, and 5 years were all trading at yields of more than 100 basis points—over a full percentage point—higher than their Treasury counterparts, yield spreads that only a short while ago would have been almost inconceivable.

There are two different, though related, factors which I perceive as being the primary forces behind this dramatic and ongoing widening of yield spreads between farm credit and Treasury securities.

First, it is undoubtedly true that the steady stream of negative reports on the agricultural economy and the Farm Credit System's finances has caused some market participants to question the credit quality of farm credit securities, although I believe this group to be fairly small.

A second, and perhaps equally or more important force behind the widening of yield spreads, is what has been called the hassle factor. Many traders and investor groups who do not question the creditworthiness of the Farm Credit System simply wish to avoid the irritations which can arise in dealing with farm credit securities under existing circumstances. Risk-averse investor groups, such as money market mutual funds and commercial bank trust departments, have reduced their participation in the farm credit market issues due to fears of market volatility, or perhaps a desire to minimize questions about their exposure to Farm Credit System financial difficulties. In a similar way, traders have become more cautious toward farm credit instruments as increasingly unpredictable yield spreads and a shrinking investor base have made them less confident of their ability to adequately hedge their positions or to find buyers at what they feel are reasonable prices.

This desire on the part of many investors and traders to avoid the uncertainties and headaches which are currently attached to farm credit securities has all the characteristics of a vicious cycle: as investors become less willing to own farm credit paper, traders react by reducing their trading activities, which results in a loss of liquidity and an additional incentive for investors to scale back their exposure to farm credit still further.

The Farm Credit System, through its funding corporation, has responded to this deterioration in the market for its securities by lowering its total volume of financing and by shifting its mixture of financing toward short-term securities such as discount notes and away from longer term issues. As the bar chart on my left illustrates, over the first 9 months of 1985, farm credit has increased its discount note outstandings by $3.1 billion, while reducing the amount of outstanding 6- and 9-month bonds and term issues by $3.8 billion and $2.5 billion, respectively, so that there has been a net reduction of $3.3 billion in total farm credit securities outstanding. This change in farm credit's financing patterns has had a beneficial effect in stabilizing the market for its long-term issues; our traders estimate that yield spreads between farm credit and Treasury issues with 5 years to maturity might be—we say here, 10 to 15 basis points, but more appropriate, in this written testimony, the more appropriate number would be 25 basis points, wider than already-wide levels had the agency not modified its financings in this fashion.

Besides raising borrowing costs for the Farm Credit System and the many farmers it supports, the deterioration in yield spreads between farm credit and Treasury securities has inflicted substantial losses on holders of farm credit paper. Goldman Sachs estimates that the market value of outstanding farm credit securities has declined by $1.25 billion to $1.5 billion since mid-July.

It must be noted that the problems of farm credit have spilled over into the markets for securities of other Federal agencies, particularly among issues with long terms to maturity. There has been a roughly 25 basis point increase in yield spreads for long-term issues of the Federal Home Loan Bank and Federal National Mortgage Association since midyear, while the yield spreads for discount notes at these agencies have widened somewhat, by about 5 basis points.

It is neither my desire nor my intention to endorse any of the proposals which have been put forth as to what actions can or should be taken to assist the Farm Credit System, and I do not choose to propose any solution of my own. I would, however, like to strongly emphasize my feeling that from the standpoint of stable and efficient markets for securities of the Farm Credit System and other Federal agencies, it is extremely important that any actions which are to be taken occur as soon as possible. Although the yield spreads between farm credit and Treasury securities have widened substantially since the system's financial difficulties were widely publicized, I doubt that very many people in the fixed income markets seriously believe that the Farm Credit System will be permitted to collapse, and that holders of farm credit securities will not be repaid the full amount of their investments.

At the same time, the absence of any strict legal obligation on the part of the Federal Government to assure payment on farm credit obligations requires that market participants watch closely for indications that their faith in Federal support for farm credit was not justified. It is for this reason that from the market's point of view, no news regarding an aid package for farm credit is decidedly not good news. The mere passage of time may give rise to an impression among investors and traders that Federal authorities are either unable or unwilling to respond to the system's request for help. Any deterioration in market confidence can be expected to produce an additional widening of yield spreads that will intensify the pressure on the Farm Credit System and the farmers who depend on its access to low-cost financing. Indeed, in the unlikely event that key administration or congressional officials should declare their opposition to Federal financial aid for the Farm Credit System, I believe it is possible that demand for farm credit securities could virtually evaporate, and that yield spreads between other agency securities and Treasury's would widen dramatically, as the market would increasingly question the depth of the Federal Government's commitment to other sponsored agencies.

Beyond my general belief that time is of the essence in resolving the farm credit financial crisis, I can identify two upcoming events which I feel could further threaten the integrity of the market in farm credit securities should there be no change in the system's financial situation by the time of their occurrence.

First, as we approach yearend, those who like myself have the responsibility for the investment policies of money market mutual funds must address the issue of whether they want to be shown as holding a large percentage of their funds' assets in farm credit securities on their annual financial statements. Lacking tangible evidence of strong Federal support for the Farm Credit System, it would be reasonable for these individuals to elect to reduce their holdings of farm credit issues, which could touch off another noticeable widening of yield spreads.

Second, should we enter the new year without any formal Federal support for farm credit, the market can be expected to increasingly focus on the timing and possible contents of the first outside audit in the system's history. The uncertainty which surrounds this report could cause market participants to become even more cautious in advance of its release, potentially leading to further defections of investors from the market, an even lower level of trading activity, and still wider yield spreads between farm credit and Treasury securities.

You should keep in mind that I am here not as an expert on economic conditions in agriculture, but as a spokesman for the market for the securities of the Farm Credit System.

Let me add a couple of things. There was an article in the Wall Street Journal this morning, at least in the eastern edition—that's Wednesday, October 30—entitled, "Federal Officials Offer Proposal on Farm Credit." Now, there was a question to the other panel here about what yield spreads, farm credit versus U.S. Treasury, had been and what they had become. Before the article this morning, when it appeared that the line of credit was being seriously considered by this administration through the Treasury, yield spreads on 6-month farm credit securities were somewhere in the range of 100 to 125 basis points above—higher than, higher in yield—than comparable U.S. Treasury securities. These are more normally—that's about five times what they would normally expect to be. With the publication and the reading of this article—which, incidentally, was not in the southeastern edition of the Wall Street Journal, and there was no response in Memphis—yield spreads declined; yield spreads, Treasury versus farm credit, from about 110 to 115 basis points to 85 basis points. And the Farm Credit Administration is this afternoon going to be pricing $1.25 billion of 6-month securities which we thought yesterday might be priced at 110 or 105 or thereabouts over 6-month Treasuries. The talk, when I talked to New York around noon, was about 85 basis points, so there has been a 25 basis point-improvement in the outlook simply as a result of what I believe is an Administration-inspired article in the Journal which, incidentally, used the term line of credit eight times in describing what was proposed. It did not quantify how big that line of credit was, but that is less important than the fact that the market perceives that this administration or this Government will ultimately take responsibility for an agency which it sponsored.

Just a couple of other things. I remind this subcommittee that I come here not as an expert on economic conditions in agriculture, but as a spokesman on the market for the securities of the Farm Credit System. I am a trader in fixed income securities, and the best definition I've heard of a trader is that it's somebody who doesn't know what markets are going to do, but at a price, we're willing to accommodate anybody who thinks he does. And that's about where we are with respect to farm credit.

One final gratuitous note, which I would associate with a position taken by a Mr. Glickman, whether or not Federal Express and Federal farm credit designations for these securities—whether we are sophisticated or unsophisticated, as far as Goldman Sachs and I personally am concerned, it's a matter of indifference how you solve this problem. But my recommendation to you, sir, is to solve it soon, because sooner or later I think you're going to have to solve it. You're going to have to take responsibility for it, put your arm around this agency, and whether it's a line of credit, whether it's on budget or off budget, is a matter of real indifference. But in the meantime it's going to be very expensive not to do that. Thank you.

I'll be glad to answer any questions.

[The prepared statement of Mr. Smeal appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Smeal.

Before we defer to the witnesses for questions, Mr. Weaver would like to go back to Mr. Gerhart for him to finish his statement.

Mr. WEAVER. Mr. Chairman, I thank you because I thought the Members would be back, and Mr. Gerhart did not use all his time.

Mr. Gerhart, would you mind reading the last half of page 2 of your testimony, and the last half of page 4?

REMARKS OF BUD GERHART

Mr. GERHART. OK. The last half of page 2 deals with problems of farm debt and financing.

The IBAA has emphasized two basic considerations. First, establishing the highest possible level of farm commodity price and income supports in the farm bill on a multiyear basis is the most critical step in preventing more farmers from sliding into insolvency. Attached to this statement is a copy of our letter sent to all Members of the Senate last week, recommending that, at a minimum, the farm income supports—target prices—must be maintained at existing levels for the next 4 years. Even this will not prevent continued deterioration of the farm economy. Farmers must have adequate income to service debt. A farm program that improves prices and farm income will benefit farmers as well as lenders, and may be less costly than massive Federal assistance to lenders.

To achieve this, we believe that farmers should have the right to decide whether they want to use mandatory production controls combined with higher price support loan levels during this period of depressed prices and overproduction.

It seems logical to us, and fair, that farmers and ranchers, whose survival is at stake, be allowed a voice in this vital issue.

The next page——

Mr. WEAVER. The last half of page 4.

Mr. GERHART. Page 4. The attached October 17 letter includes our response to the Farm Credit System's recent effort to secure major Federal assistance on a unilateral basis. We would consider it patently unfair for commercial agricultural banks to be permitted to continue to fail in record numbers—since the 1930's—and at the same time, relieve the cooperative Farm Credit System of its loan losses through a direct and unilateral infusion of money at reduced rates from the Federal Treasury. Furthermore, such an approach would not solve the problem of individual farmers in getting affordable operating credit for production purposes. We would instead prefer putting any available Federal funds into higher price and income supports in the farm bill, pending the development of farm debt restructuring plans which are equitable to all farm lenders and their farm borrowers.

Mr. **Weaver**. Thank you, Mr. Chairman. Thank you, Mr. Gerhart.

Mr. **Jones** of Tennessee. Thank you very much, Mr. Weaver.

Now I yield to Mr. Coleman, 5 minutes, for any questions.

Mr. **Coleman**. Mr. Tubbs, you were present when Mr. Swackhamer indicated a Chase Econometrics study that was made, indicating that 3,900 agricultural banks throughout rural America would lose over a third of their capital, and that the Nation's banking industry would lose close to 10 percent of its capital if additional losses were to incur from these bonds.

Have you made a similar survey or findings to corroborate that information?

Mr. **Tubbs**. We have not made a similar survey. What information I have given earlier regarding the capital loss in agriculture and the proportion of that loss that would be absorbed by lenders would be significant enough that I would not quarrel with the figures that he gave.

Mr. **Coleman**. Well, these are system losses in the Farm Credit System that would impact because of commercial banks holding half of these securities, not the decline in farm value that you alluded to.

Mr. **Tubbs**. We do not have any information on that.

Mr. **Coleman**. Mr. Smeal, the statements that have been made today about whether or not these should or should not be backed up by the Government, and people think they're backed up by the Government, all this sort of thing, would it be easier just for us to say—to guarantee these securities?

Mr. **Smeal**. Well, I expect that would be easier, but I don't think that's necessary. I think somehow——

Mr. **Coleman**. Would we get lower interest rates in the market if they were?

Mr. **Smeal**. No question about it. No question about it, significantly lower if you were to guarantee them. If you were merely to do what seems to have been suggested by this article this morning, then the initial market reaction of, say, 25 basis points, a reduction in spreads versus Treasury's, would probably be further reduced to a point where they would trade somewhat higher than Treasury issues but be close to the historical spread.

Mr. **Coleman**. If they were guaranteed, would they probably sell at Treasury levels?

Mr. **Smeal**. If they were guaranteed, they would trade subject to—like Ginnie Maes, they would trade like fully guaranteed obligations of the U.S. Government and their yields would reflect liquidity and size and the general market aspects of the securities.

Mr. **Coleman**. Why, when you mention Ginnie Maes—they are Government-guaranteed 100 percent, they say in their ad.

Mr. **Smeal**. Right.

Mr. **Coleman**. Why are they selling at such high interest rates?

Mr. **Smeal**. Well, it's delivery problems; it's forward deliveries; it's size of issues.

Mr. **Coleman**. So guaranteeing, in itself, is not necessarily—assure a lower interest rate.

Mr. **Smeal**. No, no, there are other factors——

Mr. **Coleman**. Other factors?

Mr. **Smeal** [continuing]. That can influence price besides the credit quality. The credit quality would be unquestioned, obviously, if it were guaranteed.

Mr. **Coleman**. Do you know who you sell these instruments to?

Mr. **Smeal**. Yes, but I would rather not tell you a name. But I know the categories.

Mr. **Coleman**. Well, I wouldn't ask—well, I understand that 50 percent are held by commercial banks. Is that correct? I mean, that's a statement that was made earlier in testimony.

Mr. **Smeal**. I'm not sure that a lot are held by commercial banks, that we would call that commercial banks, including their trust departments. Money market mutual funds are a significant——

Mr. **Coleman**. Is it your impression that these are some of the larger banks, or are these scattered around the country?

Mr. **Smeal**. They are scattered around—it's not only the larger banks; it's individuals, too. Farm credit securities are available in $1,000 denominations, which brings the "little old lady in tennis shoes" into this market, and we ought to have some concern for her. But I think if she buys—or he buys, or they buy—through the trust departments of commercial banks—perhaps regional banks, as much as anything else—but I think the other major holder would be the money market mutual funds of the kind that Goldman Sachs runs, institutional liquid assets.

Mr. **Coleman**. What about foreign investors? Are you familiar with who they might be?

Mr. **Smeal**. Yes, there is one significant European foreign investor who has bought these securities on the basis that he needs coupon income, or they need coupon income, rather than discount notes, and so they are significant buyers and present holders of large amounts of farm credit securities. And they are concerned.

Mr. **Coleman**. Do you feel that the $5 billion revolving fund request today would give the market a sense of confidence for—how long?

Mr. **Smeal**. It could be forever. You called it revolving fund, but I think that if this administration, through whatever agencies, through the Secretary of the Treasury, should indicate that they are doing for farm credit what they have already done for Fannie Mae and Sallie Mae and others, and make available to the farm credit agency a line of credit of some sort, the number is not that significant. The concept is material. It means that this Government has accepted responsibility for this agency; it has endowed it with trappings of high quality, and if that were done I wouldn't really care much whether the figure were $3 or $5 billion or whatever.

Mr. **Coleman**. Are you knowledgeable about the New York City bond situation?

Mr. **Smeal**. Yes, sir, I am.

Mr. **Coleman**. And when New York City floated those bonds—were they guaranteed by the city of New York?

Mr. **Smeal**. Yes, but that and 90 cents would have gotten you a subway ride back then.

Mr. **Coleman**. Did the State of New York come to the assistance of New York City?

Mr. **Smeal**. Yes, they did. They made some investments, reluctantly, through the State comptroller, Arthur Levitt, and through some of the city funds.

Mr. **Coleman**. Did they guarantee any of those bonds?

Mr. **Smeal**. I really don't know. I really can't answer the question with any great assurance because it was so unimportant. The source of the MAC financing of the city problems, which intercepted the sales tax, was the significant thing, and the Federal guarantee of a significant amount of borrowing was a significant fact. I don't think people looked much farther than that because the guarantee of the city of New York in the late 1970's was not that consequential. I don't know whether they did or not, for sure.

Mr. **Coleman**. So, as you said, that and 90 cents would get you a subway ride. When people bought these bonds, didn't they anticipate that problem developing?

Mr. **Smeal**. When people bought these bonds, they bought them on the assumption that it was a sponsored agency of the U.S. Government and that under no circumstances would there be any concern about prompt payment of principal and interest, and that is presently the point of view; 100 basis points does not measure the risk that would be involved in any other assumption. If I felt—or the people I talk to felt—that the Federal Government were not, at some point, going to be behind these securities, there would be no market, no significant market for the securities because if you had to rely on the asset structure of the farm system generally, you would not have a great deal of credit and you would certainly not measure that by another 100 basis points over the U.S. Government over the same period.

Mr. **Coleman**. Well, my statement alluded to the New York City bonds, that when buyers of those bonds bought them they were under the impression that New York City stood behind them; but the perception was that New York City wasn't all that strong. Is that correct?

Mr. **Smeal**. Well, that's true. New York City, contrary to what the Federal Government can do, could not print money. They had to——

Mr. **Coleman**. The perception on Wall Street is that the Federal Government is strong financially?

Mr. **Smeal**. Absolutely. If they are not, then we have some other problems.

Mr. **Coleman**. Welcome to Washington. [Laughter.]

Mr. **Jones** of Tennessee. Thank you very much, Mr. Coleman. Mr. Weaver.

Mr. **Weaver**. Thank you, Mr. Chairman. Let me say to my friend from Missouri something he knows very well, that we've got the printing press; we're the only one that does. [Laughter.]

Mr. Smeal, your interest is in seeing that these farm credit bonds are paid back, is it not? Whether the farmer pays them back or the U.S. taxpayer pays them back makes no difference?

Mr. **Smeal**. Well, it makes a difference; ultimately, that is our interest and the degree of probability of that occurring will depend on who's promising to pay it back.

Mr. WEAVER. Well, you're coming in, you're asking for a bailout and therefore I assume that you want the taxpayer to pay back these bonds, or at least guarantee them, which is in effect paying them back. Isn't that right?

Mr. SMEAL. I think the Federal Government ought to do what it has led the market to believe, that they will support this agency as they have supported—the New York City question is a case in point, whether it's Continental or New York City or Chrysler or Brazil or Mexico—the feeling is that this is a constituency and an agency that is worthy of help from the Federal Government.

Mr. WEAVER. You indicated through Mexico. I remember when Paul Volcker wrote out a check for $1 billion on August 13, 1982, to Mexico so they could turn around and hand it to Chase Manhattan and Citibank. Is that how we should—when all the Latin loans are repudiated, when we see that Perez openly repudiates the Peruvian loans, and other Latin loans openly repudiate those loans—do you want the U.S. Government to come in and bailout the banks?

Mr. SMEAL. No, I don't——

Mr. WEAVER. What's going to happen, then, when they openly repudiate? We all know they're not going to pay them back; everybody knows that. You know it, the banks know it.

Mr. SMEAL. As a banker, we used to say we don't make bad loans; we just renew good ones. And I think that's what's going on here.

Mr. WEAVER. I'm asking you a different question, Mr. Smeal. I'm saying when they're openly repudiated, and therefore no longer assets on the books of those banks—right now the charade that's going on, "We're in negotiation," means that they can consider them still assets on the books; but when they are openly repudiated they can no longer be assets on the books of the banks. Do you want the Federal Government then to step in—because the banks will fail; no question about it. Their assets are less than their loans to those countries. Do you want the Federal Government to step in and bail them out?

Mr. SMEAL. I don't think so. That's a tough question for me. I think there are other aspects of the question that cannot be answered by a blanket—depending on who it is, and if it were openly repudiated by a country with absolutely no possibility of repayment, I think that would be an alternative I would have to consider.

Mr. WEAVER. Do you have a personal interest in the bonds of the Farm Credit System?

Mr. SMEAL. None whatever. Do you mean Goldman Sachs, or do you mean me, personally?

Mr. WEAVER. You have a trust fund or a management fund in Goldman Sachs, don't you? Does it own any of these bonds?

Mr. SMEAL. Yes, it does; and the final maturity of securities of farm credit in that fund is September 15. We have no present plan to reinvest the proceeds of the maturing securities.

Mr. WEAVER. You're getting out?

Mr. SMEAL. Subject to what happens with respect to these——

Mr. WEAVER. Fleeing the ship?

Mr. **Smeal**. I'm getting out, not because I have any concern about the ultimate security of this bond; I think it will be paid. I think sooner or later you're going to have to do that. And if I were a speculator, I would think that this would be a very good speculation. And one of the members here read a statement from one of the services indicating that farm credit securities were an excellent acquisition at 100 basis points or thereabouts, over Treasury securities, versus the historical 20 basis points—I think that is true.

Mr. **Weaver**. You make your money, when you trade, on just a couple of basis——

Mr. **Smeal**. I still haven't answered your question.

Mr. **Weaver**. All right. Go ahead, Mr. Smeal.

Mr. **Smeal**. In money market funds, we have something called net asset value. We have to worry about the market price of the security; whether it is ultimately paid may be a matter of indifference, as far as we're concerned, and we also have trustees who feel uncomfortable about continued ownership of an agency's securities that have had this much publicity. And they would be much—this is what we call the hassle factor. They don't want to read these articles that I quoted in the Wall Street Journal indicating that the problems of agriculture are so serious, and the question I get is, "Why bother?" Why bother? Because we are interested in performance in these funds, and if the yields widen—and I expect that they'll be paid—I personally, Frank Smeal, would buy them. I would not buy them for money funds because I have to worry about what the market in general feels about them.

Mr. **Weaver**. Thank you.

My time is about up. I'm just going to say to Mr. Tubbs and Mr. Gerhart, I liked your testimony; but if the banks in this country started to fail for the same reasons, might not your positions change? Might not you see the ABA coming in here, the IBAA coming in here and asking for Federal assistance beyond what you have now?

Mr. **Tubbs**. I believe we both made suggestions that there would be a need, and there is a need right now, to support the underlying assets of the producers that we finance.

Mr. **Weaver**. I couldn't agree with you more. Your testimony——

Mr. **Tubbs**. If that is done, that then limits the loss for all lenders and would provide some capital support for those institutions and, again, confidence back to that market.

Mr. **Weaver**. All right. Thank you. Thank you very much.

Thank you, Mr. Chairman.

Mr. **Jones** of Tennessee. Thank you, Mr. Weaver.

The Chair recognizes Mr. Gunderson for 5 minutes.

Mr. **Gunderson**. Thank you, Mr. Chairman.

Mr. Tubbs and Mr. Gerhart, I'd like to pursue a couple of questions with you to try to determine your definition of fair and equitable treatment for our rural financial institutions to get a better handle on what you would or would not support.

If this subcommittee and this Congress were to recommend legislation which would do much in the line of what Governor Wilkinson advocated this morning, that would give the Farm Credit Administration more authority than they have today to regulate in a more adequate way, if it would give the Farm Credit System the kind of flexibility that they need to make their internal decisions, and it would provide that system with a line of credit of $5 or $6 billion that obviously would have to be paid back, that, with a package, even though none of those three particular provisions would address any of your commercial banks as a part of your associations, would you support it as a fair and equitable solution?

Mr. TUBBS. Would we support assistance to the Farm Credit System?

Mr. GUNDERSON. As I have suggested, because—what I am trying to get at is, we have not set up any kind of a conservation corporation to buy up all bad loans from all financial institutions; we have not set up an interest buy-down or any of that type of proposal. What we're doing is dealing with three specific measures to help the Farm Credit System. So none of them really help you as an independent banker, or Mr. Tubbs as an ABA banker. Would you, however, find what I have suggested as being a fair proposal, would you support that?

Mr. GERHART. Well, one is more regulation, and we have no position on that but certainly would not oppose it. I don't know that we would have any purpose in supporting it, but we have no opposition to that at all except that it does not help the basic problem, which is our farm borrowers. Until we make them well, we're all going to be in trouble.

And the second one, I think, was an intersystem-type of thing where, again, we have no objections to that, except that it doesn't face up to the basic problem of prices and income.

Now, the third one, we would be opposed to unilateral assistance to the Farm Credit System without something, because we feel that we and our borrowers should also have equal treatment.

Mr. TUBBS. I would basically agree with that. That proposal is not a solution to agriculture; it may be a solution to the Farm Credit System in the short run, but we still have that problem of income and we have that problem of declining asset values which that doesn't address at all.

If we have one without the other—in other words, if we have a guaranteed line of credit without any provisions for checking the powers or increasing the supervision of the system, then all of a sudden we're right back where we were 4 and 5 years ago, and we can remember that very well in terms of the banking system trying to compete with the Farm Credit System who, on the one hand, is private but on the other hand, when they go to the market, are quasi-government. And that is something that is very difficult to compete with, and I can cite some examples as to how that competition did or didn't work at that time.

Mr. GUNDERSON. I'm a little confused. We have had, through the FDIC and that insurance corporation, or FSLIC and all the other financial institutions—we have had, in essence, an insurance corporation or Government assistance come in just recently; we had the Government step in on behalf of Continental, which certainly was a bank. Why is that any different than having a guarantee from the Government through a $5 billion line of credit? I mean, I don't understand why you oppose that.

Mr. TUBBS. We're not suggesting that we totally oppose that, but we are suggesting that it ought to be coupled with a series of authority changes for the Farm Credit Administration to make them a regulator, very much like the FDIC, so that we don't get back in the same kind of a position that we were in before.

As to whether we would accept that as a package, that is something that we have not had a chance to discuss because today is the first time that this line of credit idea has been made public.

Mr. GUNDERSON. I miscommunicated at the beginning. I meant to indicate those three as one package, and if I didn't, I apologize.

Mr. GERHART. Well, then, I think our association feels that—as I said, the first two, we have no particular position for or against, but the third one, why we are opposed to it would be that we feel it discriminates against commercial banks and their borrowers.

Mr. GUNDERSON. Well, we'll debate that later because you and I have a personal difference on that one.

I would only make one final comment, and that is that I recognize, as all of you do, that farmer income is the first and foremost concern; unless you have profit, you're not going to pay back any loan. I'm not convinced that what we're dealing with here today is where you deal with farm income. I think that's the farm bill, and if you're going to ask the chairman in this Conservation, Credit, and Rural Development Subcommittee to deal with farm income in this subcommittee, we're never going to get anything passed because that's a part of the farm bill, itself. Now, that may be a good or bad package that's sitting over in the Senate, but I don't see how we deal with that here, and I would hope that we do keep those two issues separate.

I yield back the balance of my time.

Mr. JONES of Tennessee. Thank you very much, Mr. Gunderson.

Mr. Stenholm.

Mr. STENHOLM. Mr. Gunderson asked the question that I was wanting to ask. I want to ask it a little bit different to you, Mr. Tubbs.

On page 4 you acknowledge the importance of the Farm Credit System and recognize the need for assistance, but you spend most of your testimony about a future, very strong Farm Credit System.

My question is, what kind of assistance would you recommend? Or, what are some of the forms of assistance now, given the needs of the Farm Credit System, that you would recommend for this subcommittee's consideration?

Mr. TUBBS. If we can put farm debt, the bulk of farm debt, on a paying basis, then we have provided assistance to those institutions that are lending to farmers. And we have made three proposals along those ideas that would support the payment of farm debt.

The idea of a warehouse, some way, to hold this land off the market would certainly arrest declining asset values and provide the possibility for lenders to continue with some of their farm borrowers that otherwise those assets might be dumped on the market.

We are also holding out a possibility of cooperating with some kind of an interest rate buy-down along the—not too dissimilar, perhaps, from the debt adjustment program of last year. I think that the conditions have changed enough that that might get some more attention this year. My own opinion was that last year, it was a workable program and something that I think should have been looked at.

We have a tremendous amount of capital loss that needs to be shared. There are basically three places that are going to eat that capital loss. It's going to be the borrower, it's going to be the lender, and to some extent, it's going to be the Government. We need some kind of a program to address how that is going to be shared and to keep those farms in operation to the extent that we can have some interest adjustment that will provide some survival for a few more of those farm operations.

Mr. STENHOLM. You mention asset stability in your prepared statement and as part of your previous answer. Any suggestions how we might go about stabilizing the value of land in 50 States?

Mr. TUBBS. There's certainly an awful lot of consideration that would have to go into any program to try to do that, and I realize that it's a big job. But my concern is that if we don't, I don't know where we're going because there is no confidence in the land market right now. There are no alternatives, other than the Federal land bank, for financing land. If we don't have some kind of a program, there's simply going to be more and more land dumped onto the market. Those people that are capable are sitting there based on expectations of lower land prices and they're waiting. And so I just think that even though it's a monumental and perhaps difficult task, I think it still needs to be addressed and needs to be looked at.

Mr. STENHOLM. Mr. Gerhart, let me ask the same question of you. In my district, if we stabilized land at $1,000 an acre, we would make everybody well. In many States, stabilizing at $1,000 does not help the problem that you both testified to today.

Mr. GERHART. Well, I think the Farm Credit System last spring came out with the idea of an ag credit corporation or land corporation warehouse, whatever one wants to call it. That type of a concept that was handled by the Farmers Home Administration or some independent entity to take over this land that's in surplus right now, that nobody wants to buy, and keep it off the market would induce some stability into the land market.

Mr. STENHOLM. But you're both suggesting the money from this is going to have to have, I suppose, some Federal involvement. I don't know of any other place we're going to get those kinds of funds, and that's part of the problem as, Mr. Tubbs, you acknowledged in your statement.

But I guess what I'm looking for are some suggestions of how to put together a compatible package that would work State to State, district to district, region to region, crop to crop.

Mr. TUBBS. There are some proposals on the table that I'm not really prepared to go into all the details with. It would definitely require some Government involvement in the initial capitalization of that organization. Eventually, there would be a possibility—depending on what land values did in the future—that that initial capital could be restored.

I think another point that I would make is that we don't have any visions that we're going to make everybody well. I think the best thing that we can do is try to stabilize things where they are.

We know that we have some people that are not going to survive, but if we can stop that conveyor belt that keeps dumping those people off, that dumps more assets onto the market, maybe that's the best that we can do. This would be a possibility of helping in that regard.

There is a proposal that we have looked at, I know that a group of midwestern banking associations are looking at, and you've probably heard from in the past, and that's the proposal put forth by Neal Harrow. That has a combination of interest rate write-downs and warehousing mechanisms. It would help both on the income side as well as the asset value side. Those are the two key areas that we really have to address, are lower interest rates and asset values. That proposal does address it in a great amount of detail, and perhaps we will be coming back with something similar and more defined later on.

Mr. STENHOLM. I happen to agree, Mr. Chairman, that that is a primary source of a solution to both the short and the intermediate term problem, and we will welcome further ideas into how we might do this. It is difficult, but we do need that, and I thank you for the time.

Mr. JONES of Tennessee. Thank you very much, Mr. Stenholm.

And now, to Mr. Evans for 5 minutes.

Mr. EVANS of Iowa. Thank you, Mr. Chairman.

Mr. Tubbs, in your testimony you listed six principles that were important to American bankers in connection with any assistance to the Farm Credit System, and I read those over and I am very much encouraged by them because it seems to me that there's not a great deal of disagreement on most of them. I think that a lot of those things are being put in the mill by the Farm Credit System itself this morning, and I'm sure that this subcommittee intends to pursue that some.

I do understand your concerns, however. For example, capital requirements and how held, internal practices—my question is, are you going to have some specific recommendations to this subcommittee on what might be done to make the proposal more acceptable to the ABA?

Mr. TUBBS. We would be glad to do that. We have not gone any further privately than we have publicly in this testimony here this morning.

Mr. EVANS of Iowa. Well, this member would certainly welcome any suggestions that you might have, and I think some of the other members of the subcommittee would, too, as we work our way through here.

Mr. TUBBS. We'd be pleased to do that. You are absolutely correct; we have visited with representatives of the Farm Credit Administration, and we do parallel them in most of these areas.

Mr. EVANS of Iowa. One of your other items, No. 5, was the concern that we not give the Farm Credit System long-term competitive advantages, and I would agree with that; and that leads me to something that I would like to get your views on just a little bit. Would it level the playing field significantly if the commercial banks had access to long-term mortgage funds, and the commercial banks were able to perform at least some of the retailing functions now done by the associations within the Farm Credit System, particularly as it relates to long-term mortgage, something that has been extremely difficult for commercial banks to participate in in years past? Do you have any comments or thoughts on that?

Mr. TUBBS. Yes, sir. We have done studies on the real estate mortgage market, and we are very concerned about the future of that market and the availability of funds, particularly given the direction of the Farm Credit System of merging the PCA's and the Federal land bank associations under one roof, such that it would be more difficult to cooperate with somebody who is also even more directly a competitor. Therefore we are concerned about the future availability of long-term funds and recognize the need to create either a secondary market for real estate mortgages or some kind of a discounting mechanism. We believe that that funding ability already rests with the Farm Credit System, and we don't know whether something could be worked out—to be more cooperative arrangements so that we could have access to those funds. But we believe that the administrative rules would have to rest with the funding corporation rather than with the banks.

Mr. EVANS of Iowa. In that connection, there seem to be several ways that one could approach it, one through a secondary market-type of arrangement, as I think you're describing. Another one would be a participation in loans, a correspondent bank-type relationship. A third would be deposits in the commercial banking institution. There probably are some others.

Again, I think that, certainly, this member would welcome any suggestions that you as individuals or you as your associations have on exactly how the mechanics of such an arrangement could best be handled. I would certainly urge you to come forward with that sort of thing.

Now, finally, equality of treatment of all ag borrowers—and I know that that's very important to you, and I know that you also understand the problems that face this subcommittee in that regard, in that we do not have committee jurisdiction in this subcommittee or in the Committee on Agriculture over many things that relate to commercial banks; and by virtue of that, our hands are somewhat tied. I wonder if you'd comment on to what extent the agricultural/commercial bankers are attempting to get some action out of the banking committee that does have jurisdiction over those matters.

Mr. TUBBS. We have discussed these matters with the banking committee, as I have discussed them with you, and it's a matter of whether we get some of this jurisdiction moved over to the banking committee. That would be our preference, particularly with regard to the areas where it impacts banking.

Mr. EVANS of Iowa. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Evans.

And now, to Mr. Glickman for 5 minutes.

Mr. GLICKMAN. Thank you.

My first question, Mr. Smeal, Mr. Coleman and I were having a discussion about some comments I raised earlier about what is the status of this animal of farm credit securities? Are they Federal or non-Federal? And I realize that, classically, there is no absolute Federal guarantee there. But in your prepared statement, on page 2, you talk about the spreads between Treasury and agency securities and you indicate that the spreads have been small because the securities of Federal agencies are generally viewed by fixed income market participants as possessing excellent credit quality because of the sponsorship of the Federal Government.

Now, I've never seen that word, sponsorship, in any Federal statute before, and I'd like for the record for you to explain what that means.

Mr. SMEAL. Well, most of the agencies that we're talking about are generally regarded in the market as sponsored agencies; that is, to differentiate the ones which are guaranteed agencies, for example. Ginnie Mae would be an example of the guaranteed, where the Federal Government has pledged its full faith and credit to the payment of Ginnie Mae securities.

There is no legal obligation, and that is understood, for the Federal Government to support these securities, and so they sponsor them; the legislation was created by the Federal Government, the agencies were created by them, and the market—I think, properly—has assumed that in the sponsorship, they have been endowed with qualities of very high-grade securities because of that sponsorship.

Mr. GLICKMAN. OK. Rampant among this room during the hearings today is a great—I think—hostility toward the Farm Credit System, and I think that there are quite a few people in this country that would just as soon see the investors and the buyers of these bonds share in the financial liability. I happen not to be one of those people because I——

Mr. SMEAL. I happen to feel the same way.

Mr. GLICKMAN. OK. I realize that; as you state in your prepared statement, you are an investor. I am not, and you are involved in the sale of these bonds.

But what I would like to ask you is this: If the investors of this country who bought these bonds really in their gut believed that they were not going to be backed by the Treasury in the event of an emergency, what difference would it have made to people over the years in terms of buying these securities? Any?

Mr. SMEAL. The difference would have been measured in hundreds of basis points in the cost of the financing.

Mr. GLICKMAN. It would?

Mr. SMEAL. Oh, yes, sir.

Mr. GLICKMAN. Even though they were told that these were not guaranteed by the Treasury of the United States?

Mr. SMEAL. If you were told and you believed it, you would not pay the same; you would not offer the same prices for a sponsor or an agency which you think has the support of the Federal Government as you would for—you'd be just another credit that would be borrowing on its own bottom and you'd look at the basic economic qualities of the farm system, of the agricultural——

Mr. GLICKMAN. So the difference here is that even though there was a disclosure theoretically made over a period of years that these are not guaranteed by the U.S. Government, that most people who bought them believed that they really were?

Mr. SMEAL. Absolutely. There is a phrase attributed to Jim Direston which says, "It's not what you are but what you seem to be that is important," and the market has always regarded all of the agencies— whether it's Fannie Mae or Sallie Mae or Home Loan or Farm Credit—as agencies which would ultimately have the protection of the Government.

Mr. GLICKMAN. Do you agree with that, Mr. Tubbs and Mr. Gerhart, what Mr. Smeal just said?

Mr. TUBBS. Yes; banks have two levels of relationship with the Farm Credit System. There are those banks who have been competing with the system for some time that sold any farm credit securities that they may have had early in the game and would not care whether the bondholders would share some of that loss. That is not the prevalent feeling; it would create far too much disruption in the capital markets, I think, to pursue that kind of an alternative.

Mr. GLICKMAN. Go ahead, sir.

Mr. GERHART. I was just going to comment that we've heard about banks owning these securities. I would just say this, that out in the country banks—I've talked to a lot of country bankers—the prevalent attitude has been not to hold these securities ever since last spring. I've gotten out of them and so have most of the people I know about. So I don't know which banks are holding these securities, but I don't believe there are very many country banks in our area that are.

Mr. SMEAL. This is partially the result of the fact that many banks—they regarded this as an addition to their farm credit liability. If they owned farm credit securities, they had some further stake in agriculture.

Mr. GERHART. I think we have enough problems in our notecase, and many of us didn't want to have to worry about our investment portfolios.

Mr. GLICKMAN. I think this is very critical in terms of what we do here, as to what are both the legal and equitable claims with respect to the rest of the obligations issued by the Government of the United States.

Now, I'd like to ask just two more quick questions. Mr. Tubbs, you talk about the need for an independent Farm Credit Administration. You underline that word; you obviously think it's very important. And I wonder if you might analogize someplace else in Government where you think that kind of independent FCA would fit into.

Mr. TUBBS. Yes; I think the regulation by the Farm Credit Administration historically has been more along the lines of the relationship between the Federal Home Loan Bank Board and the savings and loan industry; more of an advocate, more of a cheerleader type of a regulator, not totally independent from the management and the promotion of the banks that they regulate, as opposed to the banking system where the regulatory bodies are independent and adversarial in relationship.

Mr. GLICKMAN. Do you think that the Farm Credit Administration is captive to the interests of the farm credit banks in this country?

Mr. TUBBS. I think they have been in the past.

Mr. GLICKMAN. OK.

Final question, if I might, Mr. Chairman.

The question of equitable treatment of commercial banks is a very important one. Mr. Gerhart talks about that; Mr. Tubbs talks about that, and I just think we need more specifics than you have given us as to how to define that equitable treatment in terms of what kinds of benefits should commercial bankers be given in any kind of a rescue package for the Farm Credit System. And I don't see it specifically right now, yet. And you need to provide that to us.

Mr. GERHART. Well, we have said here, in the IBAA, that we think the warehousing concept would be a form of equitable treatment if it was operated by an independent agency such as the Farmers Home Administration. This would give everybody—Farm Credit System, lenders, as well as commercial bank lenders—equal entry into something that would be of help.

Mr. GLICKMAN. Mr. Tubbs.

Mr. TUBBS. We have said the same thing. In addition to that, another proposal that we held up as having possibilities was this idea of writing off the capital loss over a longer period of time, perhaps supported in the meantime by some kind of a capital certificate on the right-hand side of that institution's balance sheet that could be carried as capital temporarily and over time, as earnings would permit, write that down and make that available to all farm lending institutions. In that regard, then, to the extent that the Government is behind those capital certificates, we would be guaranteeing capital and not guaranteeing debt, a much less bite on the part of the Federal Government than guaranteeing debt.

Mr. GLICKMAN. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Glickman. Mr. Franklin for 5 minutes?

Mr. FRANKLIN. No questions, Mr. Chairman.

Mr. JONES of Tennessee. Mr. Daschle.

Mr. DASCHLE. No questions at this time, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, sir.

I have one or two that I want to ask Mr. Gerhart and Mr. Tubbs. I've had to take a look at the testimony because I did not hear it all.

I'm at a little bit of a loss as to what each of you said, and I think I discover a little controversy in the statements that each of you made. In both cases, ABA and IBAA testimonies, both indicate that your organization believes that any Federal assistance must be formed in such a way that all groups that are in trouble must be taken care of. Am I right?

Mr. GERHART. All lenders treated equally, that's correct.

Mr. JONES of Tennessee. Yes. That's what I thought you said. But Mr. Gerhart goes a step further, and he states that agricultural banks must be provided equal access to Federal assistance just as the Farm Credit System is. Am I right, Mr. Gerhart?

Mr. GERHART. Yes. I'm referring to this warehousing concept that we're talking about.

Mr. JONES of Tennessee. Did you say warehousing?

Mr. GERHART. Well, I'd have to re-read it, but that's what our form of equal assistance generally is considered to be because that's what farm credit first started talking about last spring, Mr. Chairman.

Mr. JONES of Tennessee. But they're talking about lots more now.

Mr. GERHART. So we keyed in on that—they are talking about a lot more now. We see that as being our basic way for equal entry.

Mr. JONES of Tennessee. Well, I don't mean to put either one of you on the spot, but I got a note today—will your organizations, provided legislation is offered, will each of you—or can either one of you speak for your organizations—oppose an effort to do something about the Farm Credit System bailout, if that comes forward? Without help from your groups? And I haven't seen any effort that you've made to get any help, myself.

Mr. TUBBS. Without being available to the banking system as well, and without addressing the restructuring of the Farm Credit Administration into an independent agency and without addressing the future authorities of the system, we may have a difficult time supporting that.

Mr. GERHART. I think that the IBAA, without some type of a warehousing arrangement—which is really the only way that we see right now, that we could get equal entry or equal assistance—without that type of a vehicle, I don't see how our membership could support something that helps one segment of the lending group but does not do anything for another segment. And I'm talking about not only the lenders, but their borrowers as well.

Mr. JONES of Tennessee. OK.

Mr. EVANS of Iowa. Will the gentleman yield on that point?

Mr. JONES of Tennessee. I'd be glad to.

Mr. EVANS of Iowa. Well, I hope, Mr. Gerhart, that you understand that you're asking for something that is not within the power of this committee to grant to you. This member is going to try very hard to come up with a package that is equitable for bankers, but there are limits on the power of this committee, and I personally would view it as being extremely obstructionist on the part of the independent bankers if they arbitrarily draw the line on something that is beyond the power of this committee to give, and I think you ought to understand that.

Mr. GERHART. We don't want to be an obstructionist, Mr. Evans, but what we're trying to say is that the Farmers Home Administration is under the jurisdiction of this committee, and I would hope that we could find some way that they could be utilized, or something like that, that would provide entry for both bankers and Farm Credit Administration people because, right now, we're both using Farmers Home Administration guarantees and other types of cooperation with the Farmers Home Administration. And that's what I'm saying, is that let's use something that would allow entry for both lenders.

Mr. JONES of Tennessee. Which brings me to another question. I'm glad you mentioned Farmers Home, but first I want to associate myself with what the gentleman from Iowa has just said. I thoroughly agree with you, 100 percent.

Mr. Gerhart and Mr. Tubbs, for a good many years this subcommittee has been encouraging the banks of this country to work in conjunction with the Farmers Home Administration, and this Administration has made a big effort to get guaranteed loans—a big part of the moneys that are left there—to be used by the banks of this country. Not much improvement has been made, and I have seen very little effort on your part, or your part, out there to get something done about it. And then you sit here and tell me that a warehousing system for the lands that are in trouble in this country—they need to be turned over to an agency such as the Farmers Home Administration. You're doing nothing but talking out of both sides of your mouth, Mr. Gerhart.

Mr. **Gerhart**. I don't think so. I think I'm getting along with our Farmers Home Administration offices and have had a very good relationship with them. I wasn't aware that we were not utilizing them.

I think it takes time to get new programs going, Mr. Chairman——

Mr. **Jones** of Tennessee. Take a good look at the number of guaranteed loans that you've got out there today among your membership and see how it looks.

Mr. **Gerhart**. I think we should be using them more, but I think it takes time to get used to these things.

And I might just add——

Mr. **Jones** of Tennessee. They've been in effect for a long time and they have not been used to a very great extent.

Mr. **Gerhart**. I might just add that there's a difference between what you're hearing in Washington from the Farmers Home Administration and what their field people are able to accomplish. They're an overworked and understaffed group of people out there, and they aren't getting things done as fast, when it comes to processing these guarantees and things like that, as what the headquarters here in Washington would like to have them do. And it's nobody's fault; there just aren't that many people around to do these things.

Mr. **Jones** of Tennessee. Well, Mr. Gerhart, this subcommittee does not run the Farmers Home Administration; we just have something to do with it. And I don't take my direction from the people here in Washington, DC. I know what's going on out in the boondocks of this country because I make my trips home, too, like all the other Members do. We know what's happening.

Anybody else have a question?

Mr. **Franklin**. Mr. Chairman, if I may, I didn't take this time, but since this line of questioning has been brought up I'd like to ask the two representatives of the banking groups whether or not—if a program was established, there is a trend here, and particularly with this administration, to try to remove from the Farmers Home Administration the direct lending authority and shift it over to the private sector. It would seem to me that in the past, particularly in my area, the commercial banks and the ag banks have done everything they can to shift the risk to the Government. Now we're trying to reverse that trend, or at least some of us are. If we come up with a comprehensive program that would provide a mechanism whereby anyone who has an ag loan out there could avail himself of a guarantee, would your organizations be willing to help the Farmers Home Administration in working out some of the problems that they have with problem loans in accepting some of these loans back under a guaranty basis with the Farmers Home Administration and with the Government? Mr. Tubbs and Mr. Gerhart?

Mr. **Tubbs**. We have worked very closely with people at the USDA and Farmers Home last year, and the direction that you're talking about is absolutely correct, attempting to move from direct guarantees. And the Iowa bankers last year put on almost 1 billion dollars' worth of FmHA loans.

We are interested in servicing those loans. There are certain instances where under circumstances, I'm hearing, bankers will not take them, and they still do need the direct type of lending, particularly in the farm ownership loan area where, again, I'll mention that there's a lack of farm ownership funds. That is the most critical area.

Right now, in terms of the supervision of those loans, I think I would have to admit that there would be some reluctance on the part of the banks to take on additional supervision of critical loans beyond the ones that they've already got. Quite frankly, they are quite up to their eyebrows in trying to work out situations with their farm borrowers. To take on more would be especially burdensome at this time. That's not to say that, if things would smooth out in the future, that they wouldn't be willing to do some horse trading and accept some of the responsibility for servicing some of the loans that FmHA now has on its books.

Mr. **Franklin**. Let me just respond by saying that many of us feel that one way that we can solve the credit problem is to come with a program that all lending agencies can avail themselves of, including the Farm Credit System. And if we come with a comprehensive program, it would probably have included in it a shifting of responsibility from direct Government assistance to private participation, not only with the Farm Credit System but with commercial banks and other lenders. I'm asking you, as a conceptual idea, do you favor that as opposed to the attempted bailout proposition that the Farm Credit Administration proposes to us today?

Mr. **Tubbs**. Yes; we do. We've had that on our table for some time in terms of discussion, and we philosophically agreed with the direction of movement from direct to guaranteed lending. We would hope right now that it would go somewhat slower because of that lack of funding in the farm ownership area.

Mr. **Franklin**. Well, in the interim, when we've got the Farm Credit Administration in dire straits as they are now, do you think we ought to handle that problem first and then come with the sugar for you? Or can we do it all at one time, letting the Farm Credit Administration avail itself of the same thing that you're going to propose to us later?

Do you understand my question?

Mr. **Tubbs**. No; I'm not sure that I do. When you say—what is the sugar, now?

Mr. **Franklin**. Well, I would assume that you're probably going to want some service points to take over some of these Farmers Home Administration loans where it would make you some money, that you would have the right to call the guarantee on default as opposed to having to foreclose, and all those other things that have been talked about. Those kinds of things can be made available to the Farm Credit System just as well as they can to commercial banks.

Mr. **Tubbs**. Certainly.

Mr. **FRANKLIN**. Can we solve this problem by coming with a comprehensive program of that nature better than by dealing with them piecemeal, such as Farm Credit System first, commercial banks second, et cetera?

Mr. **BUTTS**. I think those points would certainly be helpful, but I don't see them being the solution for the problems that we're talking about today. They would certainly be of some assistance; in fact, within this past year there were some changes in the Farmers Home Administration's regulations that provide for some upfront payments on the guarantees, and so forth. So we have had some cooperation in terms of the streamlining of those programs to make them more useful. But that alone will not solve the problems that we've got out there right now.

Mr. **FRANKLIN**. By tinkering with the Farm Credit Administration?

Mr. **TUBBS**. That's true.

Mr. **FRANKLIN**. Mr. Gerhart, would you care to comment on those things?

Mr. **GERHART**. Yes; I'd like to see whatever is put in place be something that we can all use, and the guarantee program certainly would be a very usable device; however, as we've just said, we can't get guarantees on real estate loans right now. We don't have the funding for them, so that's out. And then—I have tried, in my shop, to get some loans through that just don't go because of the guarantee. I have money to loan out there; I'd love to make some more loans, but there aren't that many good loans out there in this farm area. So I would be tickled to death to have some more money put out on loans, but they have to be quality loans to keep my deposit base secure. If we could get more guarantees, that's fine, but this gets back to the problem of cash-flow. And Farmers Home insists, and rightly so, that you can't make loans if they can't pay them back or can't at least service the debt, and here we are back to the price and income problem again.

Mr. **FRANKLIN**. Thank you, Mr. Chairman. I didn't mean to take so much time.

Mr. **JONES** of Tennessee. Thank you, Mr. Franklin.

Mr. Stenholm, did you have a question?

Mr. **STENHOLM**. One question, Mr. Tubbs. What is the difference between members of your association asking the Federal Government for guarantees of foreign loans and the Farm Credit System asking this committee to guarantee farm loans in this country?

Mr. **TUBBS**. What is the difference between—would you please say that again?

Mr. **STENHOLM**. What is the difference between members of the ABA asking the Federal Government to provide some form of guarantee to loans made to foreign countries, and the Farm Credit System's coming to this committee and asking for some consideration of guarantee for loans made to farmers through the Farm Credit System in this country?

Mr. **TUBBS**. I guess I would ask the question, are there other lenders out there that are making loans to foreign countries that would be discriminated against by the guarantees to those foreign countries? In other words, are those guarantees to foreign countries helpful to one group as opposed to another group? I think the answer is no.

When we're talking about guarantees with the Farm Credit System, we're talking about treatment that is not equitable between the borrowers of that system and other farm borrowers of the banking system.

Mr. STENHOLM. Mr. Gerhart.

Mr. GERHART. The Independent Bankers Association is not suggesting guarantees on foreign loans. We would much rather see any help channeled to our own farming communities.

Mr. GUNDERSON. Mr. Chairman.

Mr. JONES of Tennessee. Mr. Gunderson, would you let me recognize Mr. Daschle? He has skipped his time, and he's got a question now.

Mr. GUNDERSON. I would be delighted to yield.

Mr. JONES of Tennessee. Mr. Daschle.

Mr. DASCHLE. I only want to ask one question, but this week is going to be a very difficult week for all of us. We're going to be grappling with one of the most controversial issues to face the Congress, the Gramm-Rudman proposal and how we raise the debt limit once again. Obviously, whatever we do is going to cost money. Whatever we do is going to come up with another bill that, somehow, we're going to have to pay for, and I would like to ask both Mr. Gerhart and Mr. Tubbs if it's the official position of your organizations to support some revenue enhancement, some increase in taxes to pay for this, or if you don't, what means do you propose that we use to pay for the program that ultimately we're going to come up with?

Mr. TUBBS. I'm not prepared to talk on behalf of the ABA as to their position on revenue enhancement. And I certainly recognize the problem that you have and that we have as citizens of this country, the deficit problems that we face, and I don't have any better solution for that than you have. But the problem is the alternative; and that is, if we do nothing in these areas, the concern is that we will wind up having a much greater cost in the long run than we may have in the short run.

And so, to make it short, I don't have a solution to where the funding comes from except to say that if we pay later, the bill may be quite a bit higher.

Mr. DASCHLE. How does that sound acceptable? I mean, we can't say that; I mean, how can you expect us to come back—and you, and so many organizations—come back and say, "Congressman, you'd better balance the budget and you'd better cut back on expenditures or we're going to find somebody else to do your job." Now we get organizations coming before us to say, "Look, we want you to do this, but, boy, we just can't come up with a solution."

You owe us more than that, and I would hope that you would give us the benefit of your thinking to face the tough issues. Don't say, "It's not my problem;" you can't do that. It's not right. I mean, I'm taking liberty to say what you can and can't do, and I realize that and I apologize, but it really is troubling to me that organizations can come to the Congress and say, "Look, consider the alternative," do this, do that, and then when we say, "How are you going to pay for it," you say, "That's not my problem," or, "We don't have the answer."

Tell us where we're going to do it. Are we going to raise taxes or are we going to cut somewhere else? But you really need to come, and I hope every organization could do that. I hope every organization at some point would have the wherewithal to come with the courage to say, "Look, this is going to cost money, and this is where it's going to have to come from," and not just come up here and tell us, "This is what we've got to do. and you've got to figure out the way to pay for it."

Mr. Gerhart, what is your organization's position on this?

Mr. GERHART. Our organization is on record for a balanced budget.

Mr. DASCHLE. Well, I applaud that. [Laughter.]

Mr. GERHART. However, I think that applies that if you can't cut costs, you'd better raise taxes. And so, now, I'll take off my hat and talk to you as a banker from Newman Grove. If you can't pay the bills, you'd better raise the taxes. Get the income up to where you can; I don't see any other way to do this. And that deficit, I think, is one of the long-range problems that has created the short-range problems that we are talking about now.

Mr. TUBBS. I would concur with that also, but I'm not on record before the American Bankers Association.

Mr. DASCHLE. OK. Thank you. I didn't mean to give you a lecture, but I appreciate your comments.

Mr. JONES of Tennessee. Thank you very much, gentlemen, and thank you very much, Mr. Daschle.

Mr. Gunderson, did you have a question?

Mr. GUNDERSON. I sort of feel like we in this subcommittee are killing the messengers this afternoon, and I apologize to both of you in that regard. But I would ask that you go back to your associations with, hopefully, carrying the message of the sensitivity that this committee has dealing with this problem and ask them to do it the same way. I recall in 1981, when I came to this Congress, we spent $720 million in direct operating loans through Farmers Home. We authorized, for fiscal year 1985, $1.9 billion; we ended up with $3.6 billion—in essence, a doubling of what we had planned on in 1985. And let's be very honest; where are most of those loans coming from? Those are loans that either the Farm Credit System or commercial banks got rid of, and they had no place else to go so they came to the Farmers Home Administration. And when you look at that kind of a situation, as we struggle with some way of saving the Farm Credit System, we need your help. What you need to do is to ask your associations to be flexible within the realms of possibilities within this committee's jurisdiction. If you're going to get into something bigger, as my colleague from Iowa said earlier, I'll guarantee you nothing will be done. You send it over to the Banking Committee, and nothing is going to be done.

So we need your help on this, and please take that message along.

Mr. GERHART. Well, Mr. Gunderson, we'll try to give you our help on that, but the basic underlying problem here is price and income, and you just explained to me that that is not the committee to talk to about that. I don't get invited to talk to the group that studies the farm bill or sets the farm bill up; they don't want to hear from the bankers on that. They hear from the farm groups on that. So this is the only platform that I have to preach from.

Mr. JONES of Tennessee. Thank you very much, Mr. Gunderson.

That will conclude the questions directed to this panel, and we do appreciate very much, gentlemen, your being here. Thank you for your patience.

The next panel consists of Mr. Ky P. Ewing, partner, Vinson and Elkins here in Washington; Mr. Don Neal, chairman, Stockholders Advisory Committee of the Federal Land Bank Associations of Texas; and Mr. Luman Holman, executive director, Grassroots: the National Association of Farm Credit System Stockholders, Jacksonville, TX. Gentlemen, would you come to the witness table and take your seats, and bring anybody with you that you like.

We appreciate your being here, and we do appreciate your indulgence. Mr. Ewing, I believe you're the first on the list; you may proceed at this time.

STATEMENT OF KY P. EWING, JR., PARTNER, VINSON & ELKINS, REPRESENTING GRASSROOTS: THE NATIONAL ASSOCIATION OF FARM CREDIT SYSTEM STOCKHOLDERS AND THE FEDERAL LAND BANK ASSOCIATIONS OF TEXAS STOCKHOLDERS' DEFENSE FUND, ACCOMPANIED BY DON NEAL, CHAIRMAN, DEFENSE FUND; AND LUMAN HOLMAN, EXECUTIVE DIRECTOR, GRASSROOTS

Mr. EWING. Thank you, Mr. Chairman. With your permission, I would like to submit my prepared statement for the record and have it appear in the record, and merely summarize it for you.

Mr. JONES of Tennessee. Without objection, that will be gladly accepted this afternoon, Mr. Ewing.

Mr. EWING. Thank you.

I appear on behalf of Grassroots, the National Association of Farm Credit System Stockholders, and the Federal Land Bank Associations of Texas Stockholders' Defense Fund. With me are Mr. Luman Holman, the executive director of Grassroots, and Don Neal, the chairman of the Defense Fund. To save you time, I'm going to be the spokesman for all three of us, but they're here to answer any questions that you have.

Grassroots was organized by farmer-rancher borrowers of the Farm Credit System and has representation from PCA's, land banks, and cooperatives in 10 of the 12 farm credit districts.

The Defense Fund represents farmer-rancher borrowers from 42 of the 44 land bank associations in Texas.

The aim of these shareholder organizations is to reflect directly to the Congress and the administration the views of shareholders of the system. They want to help the system stay alive in today's difficulties and restructure itself to carry out its essential farm credit functions in a more efficient and responsible manner, while preserving the essential local control and management of a truly cooperative system. They believe that this is still possible without an infusion of Federal money at this time.

At the bedrock of shareholder concerns for legislative change are, first, local control by farmer-rancher borrowers through boards of directors of banks and associations elected by and accountable to each institution's shareholders; second, the restructuring of the Farm Credit Administration into a true regulatory agency, with the elimination of its loan promotion and management activities and powers; and, three, returning the system to its essential banking elements in a way that will restore confidence in the system, both on the part of the farmer-rancher borrowers and on the part of the capital markets to which the system must go for its money.

We were very pleased, Mr. Chairman, to hear your and other members' remarks about the need to listen to the shareholders and ranchers-borrowers throughout the Nation, and to hear the similar remarks of the chairman of the full committee. We would urge you to do so. The shareholder groups represented here have prepared a legislative package that contains the elements of reform that we believe are essential if we are to restore confidence in the system on the part of shareholder-borrowers and on the part of the capital markets. Additional elements may be needed.

Our package does not ask for Federal assistance from the Treasury or the Federal Reserve banks at this time; indeed, in our view, the changes that we are proposing are essential preconditions which should be put in place before anyone pours Federal tax dollars into the Farm Credit System.

The 12 main items in our shareholders' legislative proposal are outlined for you at pages 5 to 10 of my prepared statement, and I won't try to read all of them. In essence, at the local level we would restore local control by having each institution's directors elected by that institution's shareholders, and by mandating published financial statements using generally accepted accounting principles.

At the national level, we propose to create a true regulatory insurance agency on the FDIC model which will have cease and desist powers to stop unsafe and unsound agricultural banking practices, and with an insurance fund which it will be required to use to insure against illiquidity and impairment of capital in system institutions after they have first used their own reserves to help themselves. Our proposed Federal Farm Credit Insurance Corporation, FFCIC, would thus have every incentive to stop the current wave of liquidations and forced mergers, for its responsibility would be to work out each system institution's problems. The FFCIC's fund would be created by an initial transfer from current system institution reserves at the lowest figure Congress determines to be required.

Funds would, of course, once in the FFCIC, be able to earn interest in the market. These earnings would be rebated to the system institutions to keep farmer interest rates down unless those earnings were actually needed to perform FFCIC's functions.

Having returned management power, as it were, back to the directors and made them accountable to each system's own shareholders, and having created a true regulatory insurer on the FDIC model, our shareholder groups propose to sunset the FCA, and further to sunset the nonbanking corporations recently spawned as service entities within the system.

In addition to these structural changes to restore the system to its essential banking functions, without which we doubt that either borrower or capital market confidence can be restored, we also propose two additional tools that Congress could add to the system.

At the FFCIC level, we would statutorily permit the FFCIC to lower the capital requirements for system institutions, currently set at 10 percent under current law, to a level not less than one-half of 1 percent above commercial bank capital requirements, which currently have a ratio of primary capital-to-total assets of 5.5 percent.

As a second tool, for the local primary lending institutions, we propose lease-back authority designed to let local decisions permit an alternative to forced foreclosure and sale of farmland collateral and machinery. In short, where viable farming operations can continue to be conducted that will produce future streams of income at current commodity prices sufficient to service the debt, we should not have to put that land onto an already saturated market and thus drive the prices of farmland even lower.

Our proposal does build in some checks and balances on the PCA's and the land banks' use of the lease-back authority by permitting our FFCIC to make special rules for lease-backs and to charge higher premiums for assets shown on the books of the PCA or land bank as being a leased-out asset.

I would respectfully refer you to our printed, long testimony for further details, but in the interests of your time I will not go further on that.

In closing, let me make four comments. I have sat with you all day long and listened to many different voices speaking at you, and would suggest with respect that at least four things are clear to some of us in the audience.

First, there seems to be a consensus that legislative changes must be promptly enacted.

Second, merely throwing authority to a Federal regulator, which is the main thrust of FCA's presentation, is not enough, in our judgment, to restore borrower confidence in the system, without which the system will simply collapse into itself. Various members have already pointed out the flight of good borrowers from the system and the reduction of the loan portfolio by nearly $10 billion in a little over a year. When you speak of the amount of Federal money that might be poured in, you've got to remember that probably the most essential fact is that shareholder confidence in this system, borrower confidence in this system must be maintained.

My third comment is that allowing the 100 men that described themselves, literally, as "the system"—the 84 directors, the 14 bank presidents, presidents of the funding corporation and the farm credit council—to aggregate further power to themselves to move the system toward a central entity bank holding company, operating in 50 States, will not restore borrower confidence. To the contrary; such an approach will further alienate borrowers who, as the Congress is aware, are already up in arms throughout the country against what they perceive as the abuses by those currently running the system. That approach, in our judgment, would move away from meaningful local control, which is the bedrock of a cooperative Farm Credit System.

Fourth, we believe that Federal money should not be provided to the Farm Credit System until the system has demonstrated that it is using its own assets to meet its obligations, something that we believe can be assured only with congressional action to create an FFCIC, an insurance regulator; and until structural changes have been made by Congress to assure shareholder rights to local control so that any future funds are prudently employed.

In conclusion, for all the reasons that we've given here orally and in our much longer prepared statement, we respectfully urge that the Congress give serious consideration to the essential reform elements contained in this shareholders' legislative proposal, recognizing that if this country is to continue to have a farmer-rancher-owned Farm Credit System that has the confidence of the capital markets and of its intended farmer-rancher borrowers, shareholder control and accountability for the system must be strengthened.

Thank you very much.

[The prepared statement of Mr. Ewing appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Ewing.

Mr. Neal, do you have a statement you would like to make?

STATEMENT OF DON NEAL, CHAIRMAN, DEFENSE FUND

Mr. NEAL. Thank you, Mr. Jones. I appreciate the opportunity to be here. I do not have any formal statement.

I would merely direct my remarks to one or two things that Mr. Ewing has already said.

One, the thing that's been said here so many times today—you'll excuse me, I'm a little hoarse; it rained in Texas, and we get a cold every time it rains. [Laughter.]

The expending of Federal money into the system until there is a handle on how much might be needed is something that I think is not wise.

Two, regardless of whatever we do in everybody's city, whatever Federal money we have to expend first should be considered into the area of increasing income for farmers because until we have that, we will not have anything. And that's just two things we have to face. I get no thrill out of the idea of asking the system to come to the rescue of the entire system because those who were either more fortunate, or possibly more prudent, shall share the brunt of that. And it will be their loss as they take out their assets, and this in turn will increase their interest cost above where it would have been had they not had to take that out.

However, I can read the law as it's stated in the 1971 act, and as I read the law, that is how it's supposed to work. I would hope that we would do that very prudently, and that we would attempt to take the money from the districts that are stronger as carefully as possible, and leave them as strong as you possibly can because, after all, tearing down the strong will not necessarily make the weak survive.

At some point in time, if this scenario is anything like it's been represented here today, which it may well be, there will have to be some Federal funds for loans; but believe me, fellas, I'm speaking just as a country boy out there, and we've got a lot of loans and we've got a lot of debt, and some more debt is just not going to get it cured for us. Stringing it out might help; some of them are not able or in a position to string theirs out while some of us are. Maybe by buying time we'll make it work.

The next thing I would address is that it will probably take some restructuring in my opinion to put confidence back in the borrowers of this system.

The next thing I would say is that maybe time is not as imperative as some of them have said to you, but I see the time as being imperative because there's a very restless group out there. This has been going on for some time now. The shareholders are restless; they are in pain; they're going to make their decisions pretty quick. Those who are able to finance somewhere else very well may begin to do that. And as they do that, then our problem becomes compounded to a considerable degree, and that's too bad.

I do not think it's wise to look back and say who made mistakes or point fingers because all of us are guilty, and let me say that I, as a land bank association stockholder and as a director, am just as guilty as many of my compadres are guilty because we didn't pay enough attention. We didn't wake up soon enough. We didn't keep close enough information on what was going on, and we should have started sooner than we have. For the last 18 months we have woke up in our district; and as we have come awake, we have seen a lot of things. I think we are better prepared now than we were, and I would hope that we can help to overcome this.

I thank you for the opportunity to be here; it's my privilege to be here, and I'll attempt to answer any question that I might. Thank you, particularly, Mr. Jones; I've seen you before.

Mr. JONES of Tennessee. Right. And I'm glad you're here today, Mr. Neal, and we appreciate very much those remarks.

Mr. Holman, do you have something you'd like to add?

STATEMENT OF LUMAN HOLMAN, EXECUTIVE DIRECTOR, GRASSROOTS

Mr. HOLMAN. Mr. Chairman and gentlemen, I'd only make the plea that this organization have the opportunity that every other corporation in the United States of America has, and that is to be able to elect the directors which are to operate that particular corporation. This is of critical importance. It's the centerpiece of our bill.

The second conclusion I would draw would simply be that the insuring corporation that we would establish that would have regulatory powers would also be that corporation that would allow the decisions to be made concerning foreclosures and other things, to be made at a local level by local people who understand local conditions. This was the basis for which the Farm Credit System was initially instituted in the beginning: local people knowing local conditions, making local decisions. This is our plea: Give the people who own the system the right to elect the boards that operate the system and to make the decisions that ought to be made locally, and not in one bank located in these United States with all of the authority, all of the money, all of the power and all of the decisions.

Thank you, Mr. Chairman, and gentlemen.

Mr. **Jones** of Tennessee. Thank you very much, Mr. Holman. And let me say that it's certainly worth the time of this subcommittee and you gentlemen to have been here today and to have said what you just finished saying. It's worth something to this subcommittee, and we do appreciate it very much.

Now, since this is a Texas panel, I'm going to refer to the Texan that's on the subcommittee and do this in reverse this time, and recognize Charley Stenholm for any statement he'd like to make.

I want you to know, gentlemen, that we appreciate the Texan that you spared us; of course, we got more than one, but we think an awful lot of Charley for this subcommittee.

Charley.

Mr. **Stenholm**. Thank you, Mr. Chairman.

Mr. **Jones** of Tennessee. Oh, we've got another Texan showed up, too. [Laughter.]

Mr. **Stenholm**. I think I'll defer to the other one, if you don't mind, Mr. Chairman.

Mr. **Jones** of Tennessee. Go ahead.

Mr. **Stenholm**. Mr. Holman, get a little more specific about the nonelection of directors and the control. I belong to the Rolling Plains Production Credit Association. The directors that represent me and have served me well are elected, as best I can tell, at the annual meeting. Am I missing something, or is there something else you are talking about?

Mr. **Holman**. If you're speaking about the local association level, all of them are elected, yes, sir, by your stockholders.

Mr. **Stenholm**. Oh, you're not talking about the local elected boards, then?

Mr. **Holman**. At the district level, your organization—whichever one of the three it is—elects only two out of seven. Therefore, there are five people who operate your organization over whom you have no authority. You cannot remove them; you cannot control them. They may do as they wish with your assets. They may operate as they choose, and it would be simply at their discretion and their wishes, which are generally contrary to the wishes of the people who own the system.

Mr. **Ewing**. Mr. Stenholm, may I just add one point on that? If you take a look at corporate governance principles, which the American Law Institute and the ABA and the American Bar Association have looked at over years, and if you look at the model corporate codes, it's almost that you literally cannot find another situation in which a bank—some of these banks have $100 million, $200 million in assets, and they have shareholders—have a situation where those shareholders do not elect all of the directors of the legal entity that loans out the money. Only in the farm credit situation do you have situations where the shareholders of a bank elect only two-sevenths of the directors. That corporate governance excludes——

Mr. **Stenholm**. Excuse me. Who elects the other five-sevenths?

Mr. **Ewing**. Pardon me?

Mr. **Stenholm**. Who elects the other five-sevenths?

Mr. **Ewing**. PCA's and cooperatives people.

Mr. **Stenholm**. Who are they?

Mr. **Ewing**. They are also farmers and ranchers, but they're not necessarily the same ones. In many parts of the country there is as little as a 15-percent overlap in shareholders of the land bank and shareholders of the Federal Intermediate Credit Bank through the PCA's.

Our point in this is to emphasize that if directors who have the ultimate authority and responsibility for prudent loan management find themselves able to not stand election at the end of the year to the shareholders of a given bank, perhaps they're not as careful as they should be about the assets of that bank. We want to correct that and get the system's corporate governance principles back in line with the corporate governance principles that apply to practically all other corporations in the country. We think it will help, in the future, to make better local lending decisions, particularly when coupled with our other requirement, which is financial auditing and financial statements—a kind of transparency, if you will—of the actions by the board of directors of the legal entity, a bank, that lends out the money.

Mr. **Stenholm**. Mr. Neal, you are a director, are you not, of the Texas Farm Credit Bank?

Mr. **Neal**. No, sir, Mr. Stenholm, I don't carry much authority with me. I am chairman of the stockholders' advisory committee for the Federal land banks of Texas. I am not a district board member.

Mr. **Stenholm**. All right; excuse me. I thought you were.

Then the two who serve representing the Federal land banks of Texas, they are not elected by the Federal land bank associations?

Mr. **Neal**. Excuse me. Let me try to answer that for you, Mr. Stenholm. They are elected by the Federal land bank associations. They are elected by the directors of the Federal land bank associations, not all the stockholders of the associations.

Mr. **Stenholm**. Do you have any problem with the method in which those two are elected?

Mr. **Neal**. I have no problem with the method in which those two are elected. I have the same problem that they're discussing, to a different degree.

Mr. **Stenholm**. I understand. But I want to ascertain the problems of the local control.

Mr. Ewing, you're speaking for the group—you have no problems with the method by which the two Federal land bank directors are elected by their local district presidents, et cetera?

Mr. **Ewing**. None at all.

Mr. **Stenholm**. Mr. Holman.

Mr. **Holman**. That's correct. We do not.

Mr. **Stenholm**. You have no problem?

Mr. **Holman**. Our bill, Mr. Stenholm, keeps basically in place the electoral mechanisms. It merely allows the shareholders of a land bank to elect all five directors of a land bank board; allows all shareholders of the PCA's to elect all the five members of the FIDC board, and similarly with the cooperatives, so that we are—at the district board level, the farm credit district board level—making the change that we believe is essential. Right now, Mr. Stenholm, the farm credit district board has four hats; the seven men have four hats. Sometimes, they're the district board, the coordinating advisory board. Then they doff that hat and put another hat on, and they become the legal board of directors of the land bank. Now, when they become the legal board of directors of the land bank, only two out of that seven have been elected by land bank shareholders, and that's our problem.

Mr. **STENHOLM**. How large a district board are you suggesting in your legislation?

Mr. **HOLMAN**. We're suggesting that each of the parts have a separate five-member board, that out of each of those five-member boards the board would itself elect one director up to a district board level, and that the farmer-rancher borrowers would elect the other two at large. And we would make the district board an advisory board.

If you think about it in human terms and structural terms, you have a legal board of directors responsible for the lending policy of each of the lending institutions. Each of those boards sends one of its members to a coordinating function, and as farmer-rancher input from the bottom, we elect two of those advisory district board memberships directly from the farmers-ranchers on a at-large basis.

Mr. **STENHOLM**. Thank you, Mr. Chairman.

Mr. **JONES** of Tennessee. Thank you, Charley.

I now recognize the chairman of our full committee, a Texan, who we think an awful lot of around here, Mr. de la Garza.

The **CHAIRMAN**. Thank you very much, Mr. Chairman, and I apologize for not being here for your testimony. I've had other commitments, but I tried to rush back before you finished. I have read your testimony and we welcome you and appreciate your contribution.

Without getting involved into the merits of the issue, Mr. Ewing, but for information for our use here, what you're trying to do by this legislation is what you're trying to do also in court in the case in Texas where the land bank is dissatisfied with the incorporation of the management. Is that not basically the thrust of your legislation?

Mr. **EWING**. Mr. Chairman, it really is not, if I may respectfully say that. What we have suggested to you here is a comprehensive package of legislation that has in it reform at the national level, at the local level, and that gives added tools to the system. It is very, very different from any of the lawsuits; and, at least speaking for myself and my firm, we're not involved in the lawsuits, so that I'm even unfamiliar with them personally.

What this is, is a package which tries to address what are the critical factors, namely, the confidence of the capital markets——

The **CHAIRMAN**. I asked that; I don't want to make it provincial, but that issue is not addressed anywhere else in the United States. It appears to be only a Texas issue, the consolidation of the management. Without taking sides, you have to understand that——

Mr. **EWING**. Respectfully, even that's not true, Mr. Chairman, because there are members of Grassroots, of which Mr. Holman is the executive director, from 10 out of the 12 farm credit districts around this Nation, and I must say to the subcommittee that the shareholder legislative proposal has in fact been introduced in the

Senate as S. 1790 by the Senator from Montana, Mr. Baucus, so by no stretch of the imagination could it be called simply a Texas bill.

The CHAIRMAN. But there is no lawsuit any other place, when they incorporated or consolidated the management?

Mr. EWING. I'm not certain, Mr. Chairman.

Mr. NEAL. If you'll excuse me, I do not believe the lawsuit addresses directly that particular question as a basis for what it was put in place for. There is included in the lawsuit the fact about the lack of representation, but only to that extent.

The CHAIRMAN. Well, what I'm trying to get for the record here, if you look at the lawsuit, your legislation addresses exactly that issue; you would not be knowledgeable of the lawsuit and cognizant of the lawsuit, but yet addressing the issues specifically in your legislation. That's why I wanted to see if we could clarify it.

Mr. EWING. Well, I only wanted to emphasize, Mr. Chairman, that the legislation certainly addresses issues far beyond what could conceivably be addressed in any lawsuit brought by anybody anywhere in the country, and we consider this a package—which is what we really would like the committee to focus on—and that is the fact that we have tried to pick those elements of reform that would do some good with the capital markets, that would do some good with the shareholders, that would do some good for future lending decisions——

The CHAIRMAN. Is this Vincent Elkins the former Governor of Texas, who is associated with this law firm?

Mr. EWING. Yes, sir; he is now retired from it.

The CHAIRMAN. Well, I think he was involved in the lawsuit.

Mr. NEAL. No, sir.

The CHAIRMAN. No?

Mr. NEAL. No, sir; absolutely not. The lawsuit is in place because, Mr. Chairman, we had no other tool to defend ourselves at that particular time. And we felt like we had a question here that was a national question, not just merely on boards. As you move into a form of single or joint management, which took place through practically all of the districts now, you not only just have the two directors that you elect to a seven-man board, but you have lost your president who went to the level of the board and represented your bank and who you directly dealt with and for whom you had much input to and from. Now you have one-third of a president in the district who represents the Land Bank, and you have a seven-member board with two members.

Mr. EWING. Mr. Chairman, it's very important for us also to add at this point that there's nothing in our legislative proposal that would prohibit or change single managements where that is the desire of——

The CHAIRMAN. That was my next question. You answered it.

Mr. NEAL. Absolutely nothing.

The CHAIRMAN. The thrust is not at the single management, but the weight of the representation within the boards that direct the——

Mr. EWING. That's correct, Mr. Chairman.

Mr. NEAL. Mr. Chairman, I'd just like to say, we have no intention in any way to alter the choice of any farm credit district as to their management at the district bank level, nor to the stockholders down in the associations as to how they want to run their associations. We're merely saying that that's their business, and they should be able to make that decision.

The CHAIRMAN. It's a very important document. My time has run out.

Let me just ask one question that I asked this morning—or I guess I made a statement, rather than asked a question—what we've been hearing from the Farm Credit Administration and the Farm Credit System, the board, and all the people who have come to Washington—members, not individuals like Mr. Holman or Mr. Neal—but all we've been hearing somehow contradicts what, as I travel throughout the country, to me appears to be great dissatisfaction with the system. The ones that are doing well, as in Texas, for example, challenge the fact that they may be forced to share their resources with one that wasn't handled properly or was losing money, that the PCA's and the land banks and all of the—when I go to the areas where there are problems, their concern and their complaint is that if they add another percentage point of interest, "I'm just going to bailout," "Why have it," and so on.

Would one of you address that issue very, very briefly?

Mr. EWING. Yes, sir, let me try it.

What we've done in this bill is to say that as long as Congress creates a new insurance regulatory agency—a new one, a three-man board appointed by the President with the advice and consent of the Senate, on the FDIC model—we, the shareholders, including Texans and including many other areas of the country that still have good reserves, we would agree to a congressionally mandated transfer of some of our reserves over to fund an FDIC-type agency which would then have responsibility on a principled basis to use that fund to help support the system.

We believe that's an essential element of a package of reform that can work, both to restore the capital market confidence and also the shareholder confidence.

But, Mr. Chairman, another essential element is to give to the shareholders who have to stay in this system not only the lower interest rates, which are very important, but also the sense that they are truly in control of it and to address that concern, which I suspect you've heard and I know other members of the subcommittee and committee have heard around the country—to address that concern, we are proposing the structural change in the way the boards of the banks are elected.

The CHAIRMAN. You may have touched on it in your testimony, but it does state, as you identify yourself—you have been retained solely by Grassroots and the Federal land bank defense stockholders, and so on? The two entities which you mentioned are your sole retainers?

Mr. EWING. That's correct.

The CHAIRMAN. Thank you very much, sir.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Chairman.

And now we'll get back on track here with any questions that anyone might have of this panel. Mr. Coleman.

Mr. COLEMAN. No questions, Mr. Chairman.

Mr. JONES of Tennessee. Mr. Stenholm—Mr. Evans.

Mr. EVANS of Iowa. Just a brief comment and one question if I may, Mr. Chairman.

I want to compliment the gentlemen from Texas for coming. I come from a very different type of district; I come from a district that's in great trouble, the Omaha district. Yours is healthy, and I commend you on that fact. But I would just like to say in support of your testimony that my stockholder borrowers share exactly the same concerns that yours do, and so it is not just a matter of concern within the State of Texas. And I'm very pleased with the detailed package that you've got here, and I assure that I'm going to look at it carefully.

I do have one specific question that I wanted to ask of a technical nature, and that has to do—what do you see as the future of the funding corporation? I got the impression that you were going to sunset that; and if so, why? And if you do, what would——

Mr. EWING. Well, sir, it's the one entity among the service organizations that we would not sunset. It is a very useful—perhaps not necessary, but useful—mechanism to get the joint bonds to the market and the funds into the system.

Mr. EVANS of Iowa. Thank you, Mr. Chairman. I yield back my time.

Mr. JONES of Tennessee. Thank you, Mr. Evans.

Mr. Stenholm, do you have any questions?

Mr. STENHOLM. None at this time, Mr. Chairman.

Mr. JONES of Tennessee. Mr. Thomas.

Mr. THOMAS. No questions, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, gentlemen. I have no questions; I am just very proud of the fact that you're here. Mr. Neal, Mr. Holman, it's good to see you again, both of you. Thank you very much.

Mr. NEAL. Thank you, Mr. Chairman. Thank you, Mr. Stenholm.

Mr. JONES of Tennessee. The next and final panel consists of Mr. Glenn Bellamy, senior vice president, Ameribanc, Inc., of St. Joe, MO; Mr. Roy Seaberg, chairman of the board, Farm Credit Banks from Austin, TX; and two gentlemen from the State of Mississippi for which I'm going to defer to the member of our subcommittee for the purposes of introduction. Mr. Webb Franklin is recognized.

Mr. FRANKLIN. Thank you very much, Mr. Chairman. My colleagues on the committee and ladies and gentlemen, we are fortunate to have two people from the First South PCA. That credit bank is located in my district. They are Mr. Robert Carson from Whitman County, MS, who is the chairman of the board of First South Production Credit, and Mr. James H. Gilfoil from Lake Providence, LA. And I would state to my colleagues that I think that these two gentlemen from Mississippi have done something very unique and very bold as far as a PCA organization is concerned; formerly 26 individual PCA associations have formed into 1 through a voluntary merger. That's called First South PCA, and we welcome them to the subcommittee and I ask you to pay close attention to what they have to say because I think they've done something very exciting in farm credit for our farmer borrowers, and they both are farmer borrowers of the system.

Mr. JONES of Tennessee. Thank you very much, Webb, and let me also say that I'm delighted to see each of you gentlemen here and may I say to my good friend, Jim Gilfoil, that I am especially glad to have an opportunity to have visited with him since he's been here, and also to Mr. Bellamy, who is here as well.

Gentlemen, we'll start with Mr. Glenn Bellamy, the senior vice president of Ameribanc.

STATEMENT OF GLENN BELLAMY, SENIOR VICE PRESIDENT, AMERIBANC, INC.

Mr. **Bellamy**. Mr. Chairman and members of the subcommittee, I am Glenn Bellamy, senior vice president of Ameribanc, Inc. Ameribanc, Inc. is a 20-bank holding company in St. Joseph, MO. Of these banks, 15 out of 20 have substantial involvement in agricultural lending.

My personal belief is that American agriculture, especially in the Midwest, is on the edge of a major financial collapse that could effectively destroy much of the Midwestern rural America as we know it; not only the farmers, but also the small rural communities. The farm credit situation is so bad now, that unless something significant is done in the near future, up to one-third of the commercial farm operators will be unable to continue.

Agriculture prices are down approximately 25 percent in almost every segment of agriculture compared to a year ago. Agricultural banks are going to find it very difficult to extend new financing to farm borrowers. Unless some method can be worked out to deal with the nonperforming assets on the lenders' balance sheets and to handle the other real estate, which is the real estate that banks have accumulated either by foreclosure or volunteer conveyance to the borrower, the difficulty of financing farmers will be much more severe in the spring of 1986.

As we discuss this, and the problem receives more publicity, this will cause more adverse reactions by discouraging investors and financial institutions from placing funds into farming. As a result, farmland prices will almost certainly drop even lower than they would have without the publicity.

The losses recognized in agriculture today are only a part of the total losses, simply because when a lender forecloses they have to find someone to buy or lease the land, or manage it themselves. To sell the land is almost impossible; therefore, the farmhouse stands empty, outbuildings deteriorate, and the value of the farm drops further. Most of the towns in the rural Midwest are now discovering they cannot rely on agriculture as an economic base the way they once did. This situation will probably worsen. Agriculture in much of this area will find it is hard to compete, and their continued problems will reflect on the communities. These communities are under major pressure today.

I would like to propose the following, that an assistance package of Government guarantees of problem loans be considered. This could be tied to the existing program within Farmers Home Administration. I would propose that this be a phase-down program where you start with a 90-percent guarantee in year one and drop the guarantee 10 percent a year. While that would not cure all the problems, it would allow farmers and lenders to deal with their problems in an orderly fashion over a period of time.

Second, early in 1985, the Farm Credit System proposed an agricultural conservation corporation which would have the authority to purchase farmland and warehouse that land for a period of time. This would allow markets that are completely saturated to recover. Farmland would be subject to purchase only when it was already held in inventory by a lender.

Each of these measures—the guaranteed loans, warehousing of land, and any others—should be equally accessible to farm credit banks and their borrowers, and to commercial agricultural banks and their borrowers. It is very important that an equitable situation be maintained among lenders and farm borrowers as deeper levels of Federal assistance are being considered. To allow any sort of unequal access to any form of assistance between commercial banks and the Farm Credit System would simply force some small commercial banks out of business, which would be the end of many small midwestern communities.

It isn't that I would propose a program that reduces bank losses, but a program that results in a gradual work-down of the problem. Bank regulations and supervisory examination positions, although sound from a normal financial viewpoint, make it impossible for many banks to survive. The loss of a farm bank just puts a nail in the coffin of the farm communities. My suggestion of the guarantee phase-down would let many banks survive.

In summary, I believe that price and income supports, and loan guarantees which allow us to bridge ourselves to the ultimate resolution of this agricultural problem, will be the best way to assist financially stressed farmers and, indirectly, to benefit the lenders.

Whatever the ultimate solution might be, I would stress the need for a system which is equally accessible between the Farm Credit System, the banks, and their farm borrowers. Commercial agricultural banks have been and will be essential to meet the operating needs of farmers and the farm economy in the spring of 1986 and thereafter. I would encourage that we keep the agricultural banks in a fully competitive and viable position in order to meet these needs.

Thank you.

[The prepared statement of Mr. Bellamy appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Bellamy.

Mr. Roy Seaberg, you may proceed.

STATEMENT OF ROY A. SEABERG, JR., CHAIRMAN OF THE BOARD, FARM CREDIT BANKS OF TEXAS

Mr. SEABERG. Thank you, Mr. Chairman. My name is Roy A. Seaberg, chairman of the board of directors of the Farm Credit Banks of Texas and a rice farmer from Huffman, TX.

I have been chairman of the Texas Farm Credit Board for 2 years and a member of the board for almost 6 years. I have been a rice farmer all of my adult life, except for the years spent in completing educational requirements.

Today, I address this subcommittee as chairman of the Texas Farm Credit Board and as a farmer and a stockholder of both a

Federal land bank association and a production credit association. The message I have to share with you is fourfold.

First, to share with you Texas' concern for the financial plight of farmers of this great Nation and add our wholehearted support for the request for Government assistance for the Farm Credit System.

Second, to bring you the perspective of a presently healthy farm credit district that yet has not suffered the severe problems and the severe losses of some of our sister farm credit organizations.

Third, to ask Congress not to require that we exhaust farm credit resources before providing Government assistance.

And, fourth, to suggest an alternative concept of financial assistance that would not affect adversely the now-healthy farm credit districts.

The common thread running throughout my message today is to ask Congress, as it considers an assistance plan for the Farm Credit System, to focus on a solution that is truly in the best interest of the farmer and rancher.

Some Members of Congress and representatives of the administration have indicated a willingness to provide financial assistance for the Farm Credit System only after all of the Farm Credit System's resources, all of its capital surpluses, are exhausted. While we do not know what the financial assistance package will look like, we do know that such a requirement places the financial position of farmers in even more jeopardy.

We have heard today about the serious and extreme losses farmers are experiencing around this Nation. As a board member of the Farm Credit System, I have always contended that the institution, the Farm Credit System, is secondary to the individual, the farmer and rancher. We believe that to ask the Farm Credit System to contribute all of its available financial resources before Government provides assistance focuses our concern on the institution, the Farm Credit System, and disregards the farmer and rancher.

It is clearly the intent of Congress, as stated in section 1.1 of the Farm Credit Act of 1971, as amended, "* * * that the farmer-owned cooperative Farm Credit System be designed to accomplish the objective of improving the income and well-being of American farmers and ranchers by furnishing sound, adequate, and constructive credit * * *"

Congress properly intended that the Farm Credit System exist to serve farmers and ranchers beneficially. If the system cannot do that, it no longer has a reason to exist.

The focus of any assistance plan must be on the needs of farmers and ranchers—farmers and ranchers who have exhausted much of their personal resources and are watching their equities in the Farm Credit System rapidly erode. The exorbitant interest rates paid by farmers and ranchers these past several years have added literally billions of dollars to their operating costs and contributed materially to today's financial disaster. Additionally, artificially high rates, consciously induced by agencies and instrumentalities of Government through some grand experiment in macroeconomic management, are the principal cause of the burgeoning surplus of agricultural commodities and the resulting present low prices.

It is a fact that we farmers are not producing more today, we are simply selling less because of dollars overpriced by high interest rates in the United States.

The capital surplus of the Farm Credit System, just as in any financial institution, is a major component of interest rates paid by borrowers. To further exhaust these surpluses, thereby adding to the already high interest rates paid by the farmers and ranchers we serve, seems to us an irrational exercise in futility, contributing even more to the financial problem of farm credit farmers and ultimately, to the financial problems of all farmers, and ranchers.

Interest rates today in the Texas farm credit district are among the lowest in the Farm Credit System, but they are too high. Even some of our farmers are paying an effective rate of more than 14 percent. This represents a real interest rate that exceeds the real rate of interest of a few short years ago, when the prime rate was 21 percent, and farmers and ranchers of other farm credit districts are suffering from even higher interest rates. We believe the Farm Credit System has exhausted all of the resources we can without creating even more problems for the very people we are trying to help—the farmers and ranchers.

The Texas farm credit district is healthy today. Loan losses for our Texas district this year are projected at between $6 and $7 million—small when measured against our loans outstanding of more than $4 billion.

The Texas farm credit district is proud of its record. We believe we can remain healthy if the agricultural economy materially improves, and if we in Texas are not required to give up our reserves.

However, our projections for agriculture in Texas are similar to those you have heard and will hear today. Declines in land values are taking their toll, particularly in the High Plains area around Lubbock.

Many of our farmers who have hung on these past several years have done so because of some visionary juggling. If cotton prices looked good, they planted cotton. The next year, if milo promised more, they planted milo, and so on.

The juggling has about come to an end. The seemingly endless search for profit has exhausted even many of our best farmers. USDA figures and our own calculations indicate that U.S. farmers are worn; their management abilities have been tested severely; many of their equities are gone. Texas cannot be far behind. We live with the same commodity prices and continued lack of profit as the rest of the Nation.

There is still time to help farmers and ranchers who are still viable. I do believe that our Nation's farmers have withstood all that they and their management abilities can tolerate. Surpluses, low prices, the cheap food policy, the high value of the dollar, high interest rates—all are uncontrollable from the farmer's perspective. All have worked against him.

We think that the farmers and ranchers have done their part. We think that the Farm Credit System has done its part. Now is the time for Government to do its part.

The Texas district would suggest another concept. Establish an amount of aid for the Farm Credit System, based on what you have heard here today, that represents the needs of the system and fund it as needed. Based on established criteria, banks could apply for help as help is needed. Government equity capital would be infused into requesting banks through approval of a designated Government entity, such as USDA or Treasury. The capital would be retired based on prearranged, individual terms. Such a plan would help troubled farmers and troubled banks without creating problems in untroubled banks.

We anticipate the amounts to be requested would be small based on Farm Credit System district pride. The time of take-down and payback would be stretched out and, therefore, the peak amount outstanding would be less than a single, concurrent investment in the banks.

We Texans have always lived in a risky environment where tornadoes, hurricanes, drought, hail, floods, and pests were prevalent. Some or many of these come to Texas every year. They came this year. They will come next year. A major drought or a mean hurricane can devastate our State. In the past, we have weathered the storm. We believe we can probably weather it again, but only if we are allowed to remain viable.

The Texas district is an inextricable part of the Farm Credit System. We have willingly come to the aid of two of our sister banks. We accept our responsibility to support the Farm Credit System as we ask for financial assistance. While not asking for help for ourselves, we know that many of our sister banks are in serious financial condition and their survival without Government help is doubtful.

The Texas Farm Credit Board feels as if Texas farmers and their farm credit district have met the test imposed by the recent agricultural environment; that is, to be prudent; to tighten our belts; to operate in a risky environment; to keep our loan portfolios in good shape; to make wise decisions; to manage our business well, to be selective in the use of innovations in a deregulated financial industry.

We know, too, that if farm income does not materially improve, despite the best efforts of Texas farmers and ranchers and their Texas district banks, severe financial stress will overtake our district as well.

We believe a healthy, vibrant agricultural economy is essential to the long-term economic security of this Nation. We believe also that a healthy, vibrant farmer-owned cooperative provider of credit is essential to a healthy agricultural industry.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Seaberg appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you, Mr. Seaberg.

Mr. Carson, we'll be glad to hear from you.

STATEMENT OF ROBERT A. CARSON, CHAIRMAN OF THE BOARD, FIRST SOUTH PRODUCTION CREDIT ASSOCIATION, JACKSON, MS

Mr. CARSON. Mr. Chairman, let me express my appreciation to you and your subcommittee for your patience and for your politeness, and at the hour of the day, I believe you are more polite than you are patient; so I will try not to keep you here too long, but I do have a few things I want to say to you. I don't want to read a statement to you; I may refer to it. You can read as well as I can; it's been supplied to you; the information is there that I have, and I will be glad to provide further information.

Mr. JONES of Tennessee. Mr. Carson, if you will yield for just a moment, you are the one that we've been looking for all day, and we~~'ll be~~ glad to make your statement a part of the record.

Mr. CARSON. Thank you, Mr. Chairman. I do appreciate it. And I might have saved you some time, if you had called on me first this morning. [Laughter.]

Mr. JONES of Tennessee. Next time, we will.

Mr. CARSON. Mr. Chairman, with me today is Mr. Jim Henry Gilfoil from Louisiana; he and I represent the 21-member board of the First South Production Credit Association. Our association is in the fifth farm credit district; its headquarters is in Jackson, MS. It's made up of 16 former PCA's that were across the three-State area of Louisiana, Mississippi, and Alabama. So we appreciate the opportunity to talk to you gentlemen in the subcommittee forum and give testimony. Some of this we have gone over with some of you individually at a prior visit up in Washington.

The major problem in agriculture today, and I don't have to tell you learned gentlemen this, is a lack of profitability. And all the patches we're trying to put on the system, all the patches we're trying to put in our farm bill, all the actions that we're taking are really just patches until we can return profitability to agriculture. There would be no need for these hearings today or for last week or for tomorrow on both sides of the Hill; there were no credit problems in agriculture until commodity prices fell out of bed. There are many factors that caused that. I don't have to tell you that; you know that they're beyond your control, they're beyond the control of the farmers, but they exist. They are real, and we have to live with them. And those have to be addressed.

Profitability must be brought back to agriculture before we're going to settle our problems. It's got to be brought back. The vicious cycle that we go through of falling income, falling land values, farmers' equities being wiped out is just about to bring us down to the very bottom of our barrel.

The PCA's in our district went the extra mile. We did not make bad loans; loans go bad on you when they're made, but with the rapid deterioration in the economic situation, a loan that was good in January when it was made could be disastrous in November or December, when you're trying to collect it. These are things that are beyond the ability of individual farmers to control. Who knew that the policies of this Government, whether they be foreign policies, whether they be defense policies, whether they be fiscal policies, were going to bring us to this? But we're there, as I say, and what do we do?

The PCA's in our district have gone the extra mile. We have lost some $60 million over the past 3 years. We have lost all of the assets or the collateral or the reserves that we have built up over 50 years, and we saw that something had to be done.

Now, they call me "Mr. Merger" where I come from; in the last 12 months, I've been chairman of the board of three different PCA's. That all came about because of the way that we were trying to put two, three, or four PCA's together and then by the time you get that accomplished and look like you're about to get a handle on things, here comes another thing that you need to get even larger.

All of this information about merger was presented to the grassroots directors of the PCA's across this district. At no point in time were we told we had to do anything; we were only supplied the information that we asked for.

Now, I've heard you gentlemen ask over and over today, "Why are you so late," to some of the people testifying before you, "coming in and telling us about this?" I can tell you a little secret. Mr. Jones says that he goes back home, and the rest of you men go back home at times, and you have known for 2 years or more that we've got a problem. We've got a problem with agriculture, and we need to address it.

Now, the wheels of legislation and justice and whatnot turn very slowly, but the grassroots producer knew there was a problem. And we began to recognize that there was a problem on the FICB side of the fifth farm credit district. We took it by the horns and decided we would do something about it.

Now, when you bring directors from 16 different associations across three States who only know how to fight over what football team or State University is going to do what to so-and-so, it's kind of difficult to get them in a group to say, "Yeah, boys, we're going to work together." You're taking directors who have real estate, as we call it, the little associations that they served and the geographic area that they had, the political things—and believe you me, gentlemen, in farm credit there's just as much politics as what you sit in—and they have to get over these feelings. They have to get rid of these real estate problems. They have to put behind them employees. I mean, we wanted to do something for the benefit of the farmer, and we think that everything we have done has been for the benefit of the farmer. We have instructed our management people in First South PCA that we weren't doing what we were doing to provide positions for employees. We were doing what we were doing to bring help to the producers of agricultural products in the fifth farm credit district. And if it didn't bring help to them, don't do it.

Now, that's just how straightforward we have been. Management never interfered with us 1 minute. We were given the information we needed. We hired outside counsel. We hired outside accountants. We hired the best expertise that we could, outside of the Farm Credit System. We didn't want anybody coming in that had that background that might tend to lean things a certain way. And finally, when we had all the information gathered together, and I asked this accountant, I said, "Well, when do you think we should make a move to merge?" He said, "Yesterday." And I'm inclined to agree with him. We were a day late and a dollar short, but at least we were moving.

So what I'm telling you gentlemen is that the First South PCA is the first districtwide PCA in the United States. We did it from the grassroots level up; we have grassroots control over what we are doing. The 21-member board that sits in Jackson, MS, once a month has a great deal more control over our system than we ever had as divided—16 different little boards of directors serving little personal interests. We have a handle on everything that's going on. We have regional directors who are former PCA directors in the 26 operating regions in which we operate across the three-State area. These men are elected by the stockholders. These men are grassroots representation. The directors, the 21 directors at the Jackson level, the PCA level, they are elected from the grassroots. We have absolute grassroots control.

Now, there are two things that we set out to do. One of them was the grassroots control that I've been telling you about, and the other was for greater efficiency. The day we brought this system onboard, the First South PCA, we dropped our average interest rate from 12.25 to 10.7 percent; there are a lot of stories behind that, too, and we can answer that, I think. But if you think that doesn't get borrowers attention? We told them what we were going to do; we told them what we set out to do. And when you drop almost 2 percentage points the day you start in business, they say, "I believe you. I believe you." And 92 percent of the stockholders who voted on the merger process voted for the merger; 92 percent. We had overwhelming support, but we went out and sold the concept, sold the idea, and we told management to stay out of the picture. We didn't want any seeds sown of dissent; we didn't want anybody protecting a job or a position. What we were doing was for the benefit of the farmers in the fifth farm credit district.

We have had the interest rates dropped. Of course, we had one thing going in our favor; the cost of money went down about that time, I'll have to recognize that to you. Second, we were able consolidate control of the fifth district FICB and the PCA capital, and most of it is FICB capital; the PCA capital is about gone. But we were able to consolidate our capital. And third, was a reduction in the operating budget because we had a RIF; what it amounts to is a reduction in people. And this had to be done.

We feel like we have now come up with a responsive group of employees who know what job they have to do and will do that job, or will be replaced. We are not offering a position of semiretirement to farm credit employees. We expect performance, and the performance will be measured.

I reemphasize again, gentlemen, we did it from the grassroots level. You can call on anyone who's a member of the board or any of the borrowers across that district and they will tell you that they have just as much control as they ever had, and probably a whole lot better understanding.

I'll tell you something funny about mergers. They talk about these district boards here; some of them have just testified that they want a board to represent FICB, one FLB, and one the BC's. And I have a suspicion or a thought that maybe some of these boards, the way they are constituted now—two, two, and one, which makes the seven, Mr. Stenholm, that they have—that they weren't too responsive to the grassroots membership because they were elected by a diverse group of associations who never had a chance to get their heads together and say, "Look, boys, maybe we've got a common interest. We ought to look and see who we're electing."

Gentlemen, the First South PCA, 21 men sitting every month—and they are the ones who elect the two FICB directors—we've gotten more attention in the last 2 months from the FICB directors than we have ever had. Some of our directors even know who the FICB directors are now, and this is something that they did not know. They knew some of them by face, but not by name.

It's remarkable, gentlemen, when farmers decide that enough is enough, plus you've got to do something, boys, so it's better to walk in with your head up and say, "Let's get the job done," than to crawl in on your stomach and say, "Please help me." I think we're coming to you before we're on our stomachs, and we need some kind of help. And I'm sorry, I can't come in here; I'm supporting—First South PCA is supporting the position that farm credit has testified to you here today, to seek help, and we heartily support that. We have maintained, at the First South PCA and the task force that formed it, for over 12 months that there was a need for some injection of capital into the system.

The fifth farm credit district has sent funds to Seattle; it has sent funds to Omaha, and now we are about to get into a position where we—and I say we, the fifth farm credit district—is not going to have enough funds to adequately operate their own system. And they, in turn, may have to turn around and say, "Look, Texas, we need some funds." This is not going to get the job done, gentlemen. If we give the Farm Credit Governor some type of revolving fund or some type of funds where he can inject funds into troubled groups and they can send theirs back to those banks, whether it be Columbia or Louisville or Jackson or anywhere, and they can get that capital back into their box, then they will have greater security and a better way in which they can deal, and be a stronger institution.

So that's the reason that we are asking that something be done, but we don't want a handout. I don't like the term bailout; I don't care how you spell it, but maybe that's what it comes out to. What we want is an opportunity to get back on our feet if other factors involved will let farming become profitable again, get back on our feet and then pay this money back like it was done once before.

We need your help, gentlemen. We need your understanding, but by the same token—I'm sorry Mr. Daschle is not here—I think we're obligated to bring you a solution to some of the problems, and I think what First South has done is a solution to one of the problems, that farmers can get together. They can get their act together, and they can become effective. We have gone as far as we can as dirt farmers, as directors of a PCA. Now we come to you gentlemen and say, "Give us a little help," and we'll justify the confidence that you put in us.

I thank you very much, sir, and Mr. Gilfoil has something to say, if you will give him a few minutes. I'm sorry the red light caught me; I apologize to you.

[The prepared statement of Mr. Carson appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Carson, for a very good statement. We appreciate it more than you know.

Mr. Jim Gilfoil, you are recognized now for any statement you might make.

STATEMENT OF JAMES HENRY GILFOIL III, DIRECTOR, FIRST SOUTH PRODUCTION CREDIT ASSOCIATION

Mr. GILFOIL. Thank you, Mr. Chairman. I, too, would like to express my appreciation to you personally, to the subcommittee as a whole, and to the group of witnesses and others who have stayed here through this long day to hear what we have to say.

Now, it's redundant for me to go back over what Mr. Carson has so ably presented, and I do think he did it well. I can't think of any points that he's left out. I would like to emphasize that this is something that we have done not in the past month or two, that we've been working on this establishment, or what wound up in the establishment, of the First South PCA for the past 2 years, approximately. It was a most difficult thing; each district, each State, each association had their own interests that they tried to protect. They resented others telling them what they should do. They were afraid of what others might do to them if they were in a stronger position. We had to overcome that, and it wasn't easy.

We looked first at merging a few associations within the States, and then going, in some cases, to two associations for the State. In the case of Alabama, they had settled on maybe the idea of four associations for the State. And we talked in terms of one association for each State. But as is so often the case in our part of the country, those from Louisiana are the most quarrelsome and the most reluctant to do anything. You've got a bunch of folks from north Louisiana who are essentially hillbillies and rebels, mixed up, and another group from south Louisiana who are Cajuns, who are better known as coonasses in that part of the country, and when they get together, well, they can really put on a good squabble.

Mr. COLEMAN. We find that true here in the House with your delegation. [Laughter.]

Mr. GILFOIL. I appreciate that fact.

Anyway, this all culminated—Mississippi had chosen their direction, and they were going with two associations; Alabama was going, maybe, with four, and we in Louisiana still hadn't made a determination. So we had a final meeting, and we fussed and we fought and we argued, and we were about all in a state of despondency, those who hadn't already pulled out all their hair, and we finally just got to talking. We said, "If we're going to do this thing, why don't we do it right and go to one association for the whole district?"

Well, of course, they started objecting to that. And then I thought of an idea that might kind of quiet them down, and that was to bring up what had happened—or some of what had happened—in the Civil War. And this might not be a familiar fact to most of you gentlemen; I'm sure it is to some of you, but one of the chief reasons we rebels lost that war was the very type of government that we had in the Confederacy. Rather than having a unified government, we had a government made up of a bunch of conglomerate States. Each State wanted to preserve its own army; they wanted their own commander, and they wanted to fight on their own ground. And they were most reluctant to send soldiers to another area, however important it might be, and place them under the command of a man from another State. And that contributed greatly to the result of that war.

So I made that analogy in that meeting, and at once it seemed to act as a catalyst to bring that group together, and we decided we'd better get unified. And from that, we became ambassadors to other States to persuade them to do the same thing. We went first to Alabama; we went then to Mississippi, and we set up a task force in the three States and we worked together and worked together over a period of many months and through many wrangles and successfully put this together. And we're very proud of what we've done.

I would like to make one other point. I've heard it often here today that this proposal of putting Federal money into the Farm Credit System is a bailout; you can call it infusion of funds, letter of credit, or whatever. Bailout is not a very good term as I see it.

I think we should look on it, instead, in terms of a partnership between the U.S. Government and a very large segment of the farming community in this country to protect the interests of the agricultural community and, ultimately, of the whole community of the United States because without the farmers of this country, without them being able to continue to operate, how would you have a System where most of the people—or a very large portion of them—can afford to go out and eat because the food is so cheap, even to the point that sometimes the wrapper that the food comes in costs more than the food itself? And that is the very reason that there is such an imbalance, economically, in the country. The farmer is receiving so small a part of the economic returns in the country that there is no way that he can continue to do this and lose money and provide these goodies for all the rest of the people unless he has some assistance somewhere.

And as far as justifying it is concerned, I would like to say that over these past 50 years, since the PCA's, for instance, have been in business, the original infusion of money that the Government made to get the PCA's off on the right foot has all been repaid. I think perhaps the mistake that was made at that time was that there was not established an open line of credit in the beginning, to be used in such times as those we face today. And I think we need to look on it in those terms.

I was glad to hear Mr. Seaberg say what he said. We are at the point in the Farm Credit System—we may not have completely exhausted all of our resources, but if we go further toward that end, it is going to have one immediate result, and that is to raise the cost of money to those who can afford it the least, and that is the farmer.

Thank you very much.

[The prepared statement of Mr. Gilfoil appears the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you.

Mr. Coleman.

Mr. COLEMAN. Mr. Bellamy, thank you for coming from our district today. I thought it was important that somebody from Ameribanc or a large lender be represented in these hearings.

How large is your ag portfolio now?

Mr. BELLAMY. Approximately $200 million.

Mr. **Coleman**. And how much of that is nonperforming now?

Mr. **Bellamy**. There would be approximately $10 million of it that would be nonperforming now.

Mr. **Coleman**. Out of $200 million in ag loans, you only have $10 million that really aren't performing?

Mr. **Bellamy**. When we refer to nonperforming, are you referring to total nonaccruals or——

Mr. **Coleman**. Or any stage, I guess, in that area.

Mr. **Bellamy**. Probably, if we took the totals, there would probably be around $20 million, but that's not all nonaccruals.

Mr. **Coleman**. Uh-huh. And one of the things you suggested was to work with the guaranteed program of Farmers Home.

Mr. **Bellamy**. Yes, sir.

Mr. **Coleman**. Are you utilizing guaranteed programs now?

Mr. **Bellamy**. Yes, sir, we are, to the degree that we can. As you're very well aware, the guaranteed loan program as it exists today varies very much between States. And as you're aware, we're also involved in Kansas, Nebraska, and Iowa to some degree, and it's much simpler to get guarantees in some States than it is others.

Mr. **Coleman**. Of the four States you work with on FmHA guarantee loans, where does Missouri rank in cooperation you receive?

Mr. **Bellamy**. They are much more difficult than either of the other three States.

Mr. **Coleman**. Any particular reason?

Mr. **Bellamy**. The only reason that I know of is because there's some difference in interpretation or methods of implementing the program by the State director in that State.

Mr. **Coleman**. How much land have you had to take back through foreclosure or conveyances, back to the bank?

Mr. **Bellamy**. We've taken back land through foreclosure, of course, but we've taken back substantial amounts of land through voluntary conveyance. They just gave up. We have about 21,000 acres.

Mr. **Coleman**. And you say that there's no market for a lot of this land. Do you have a for sale sign on it, but nobody's buying?

Mr. **Bellamy**. Certainly, we do have. You know, we'd do anything reasonable to move that land, and we have had it for approximately 2 years and you cannot sell it.

Mr. **Coleman**. And you're saying that the idea that the Farm Credit System had at one time to warehouse these parcels is something that you would definitely want to participate in?

Mr. **Bellamy**. Yes, sir; we would.

Mr. **Coleman**. In all 21,000 acres? Do you feel qualified for that?

Mr. **Bellamy**. I'm sure that the criteria which would have to be set up on that—there would—not all of those 21,000 acres meet that criteria, which would be fine. But there would be some of it, I'm sure, that would.

Mr. **Coleman**. You stated the farm credit situation is so bad that unless something significant is done in the near future, up to one-third of commercial farm operators would not be able to continue. Is that just in your service area, in our area?

Mr. **Bellamy**. Well, of course, I spend more time in north Missouri than anywhere else, but I see some problems in other States, also. But I am referring, certainly, to that area, yes.

Mr. **Coleman**. That's a tremendously high figure that I have never seen before anywhere—

Mr. **Bellamy**. It certainly is. I believe that.

Mr. **Coleman**. Well, then, Mr. Stenholm can appreciate my earlier comments when I said how frustrated we get sometimes.

Well, I appreciate you coming, Mr. Bellamy, and for the rest of the panel, and I don't know if it just happens to be the area down there or the two representatives that were sent over here—Mr. Gilfoil and Mr. Carson—but I would imagine that you two could get a lot of people to do a lot of things if you wanted them to. So it may be the personalities involved; I don't know. I congratulate you.

Mr. **Jones** of Tennessee. Mr. Thomas.

Mr. **Thomas**. No questions, Mr. Chairman.

Mr. **Jones** of Tennessee. Mr. Evans.

Mr. **Evans** of Iowa. No questions, Mr. Chairman.

Mr. **Jones** of Tennessee. Mr. Franklin.

Mr. **Franklin**. I just have a couple of questions for the representatives from First South PCA, and I want to thank you both for coming here and explaining as you have so adequately done the kind of energy that exists in that area for the good of the farmer.

Is the fact that you have merged, now, in a three-State area, is the perception out there among the local borrowers that he has a say-so in what happens to his PCA?

Mr. **Carson**. Yes, sir; he should have the understanding that if he has any interest whatsoever, he knows now that he is being fed more information than he did when he had five little directors that were representing a three-county area or a five-county area, that he has more input—the First South PCA directors meet monthly with all of the regional directors. In other words, the seven directors from Alabama meet with each region—not all of them together, of course, but the one from that area; the regional directors are elected by the stockholders in that particular operating region, and the PCA director is elected by the same stockholders. So when you have an annual meeting you have two nominees for a PCA position and one or two for the regional position. And these people understand that if they want information on the PCA or farm credit—good information, not Wall Street; everybody gets that—then all they've got to do is go by that office; all they've got to do is go by that director from that region and find out exactly what's going on, because I do—and I know that Mr. Gilfoil does and the other 19 members of the board—convey immediately after our monthly meetings to these regional people what has transpired. They have copies of our policies. They have copies of budgets, and they, in turn, review the local loan situation.

Now, granted, it's postreview, but if there's a problem and something gets out on the street, it's no surprise to these men. Nobody can come in and say, "Did you know they're foreclosing on so-and-so" or whatnot? No. We have told the loan officers and the office personnel, "Don't pull any surprises on these directors. If something's out there, you inform them of it and then they can make an intelligent answer to a question."

The rumor mill is killing us, gentlemen. Farm credit is not bad enough; they have foreclosed by rumor every farmer in the north delta part of Mississippi—and maybe they need foreclosing on; I'm in the group—but by rumor, every piece of land is up for sale. It's raining down there now; we're getting a spinoff from another hurricane, but the blues of the farmers are far worse than the gray clouds that hang above them simply because of rumors and the situation that we find ourselves in.

Mr. Franklin, I did not mean to go so long. You asked me one question, and I took it and went all the way around; but I tell you, yes, sir, they are better informed.

Mr. Franklin. All right; let me ask one more and then I'll leave you alone, Bob.

As you know, and Mr. Gilfoil is well aware of the fact, that the penetration of the Farmers Home Administration into the credit markets of the three States that now constitute First South PCA is tremendous. In my district it's 65 percent. With the trend in Washington to move away from direct loans and to move into more of the guaranteed loan programs, it's obvious that the PCA's and the commercial banks are going to have to participate in order to salvage the whole farm system in our area.

Is your PCA looking into anything or doing anything about coming up with ways that, maybe, this reorganized PCA can participate more in the guarantee programs that emanate here?

Mr. Carson. Mr. Franklin, about 3 or 4 months ago the First South PCA board of directors asked our management to—incidentally, we have a unique situation in that the president of First South PCA is also president of the FICB at Jackson, MS; he's wearing two hats, but we find that very, very well-working right now. There could be some problems down the road, but we don't have it now. But we asked our management people to investigate what might be done in the light of a statement that is either in the House or the Senate bill that there would be no direct FmHA loans and no more new borrowers, that we recognized that the situation would almost be disastrous, certainly in the areas which Mr. Franklin and I come from, and maybe even in greater areas. But that something had to be done to maintain some stability and to avoid the domino effect that might take place if all of a sudden all credit institutions back off and down they come, and the good certainly going down with the questionable.

We asked them to formulate what we could live with. Now, this was building on a proposition that a year ago, in January, this coming January, when the Congress was talking about a 10-percent write-down or a 90-percent guarantee or whatnot, we quickly went in and said to FmHA people, "We can go with 100 percent and possibly a fee for handling some of these loans." And we were laughed right out of there. We have since come back—and I'm sorry Mr. Daschle is not here because he was the one who made the point, "Tell me how to do something. Don't come and tell me you want something done; tell me how."

We've got a plan in place and a program that we want to present to the Congress and want to let you look at it and to see what we can do. We think it is a good program, not only for the farm credit institutions, but for the private banking system, that it will fly and that it, in time, will accomplish what needs to be done. Neither Farm Credit nor FmHA or the private banking system feels like they have to keep everybody in business; but if we ride along, if we keep people working, then maybe in time this commodity price thing will turn around that we talked about, and then people will pay their own way out.

I don't know of a segment in this country that wants to get out from under the gun and get out from under Congress and USDA any more than farmers do, but they can't do it by themselves.

Mr. Franklin, we have a program that we would like to bring to you. We are looking at it very strongly. It's something we can live with; I think FmHA can live with it, and I think that Congress will approve it, and we are ready to move forward on it. But it needs to be implemented quickly; loan season's coming up again, believe it or not, and it's coming up much quicker than we think, and we would like to be in position to go ahead with this type of program.

Mr. **Franklin**. Thank you, Mr. Carson. I'm familiar with the proposal that you—I know I didn't want to spring it here ahead of time, but I compliment you and those people who worked with you in trying to come up with innovative ways to address the problem from the level where it really means something, and that's the grassroots level. And I thank you very much, and Mr. Gilfoil, for coming here and giving us this excellent testimony.

Thank you, Mr. Chairman.

Mr. **Stenholm**. Let me say, what a fitting ending for today, Mr. Chairman, the spirit and enthusiasm of the last panel has been refreshing and makes those of us who get to come back tomorrow at 9 o'clock get a fresh start.

Mr. **Carson**. Mr. Stenholm, if I may, let me say that in implementing the request made by FCA this morning, there are two things—and they're pointed out in our formal testimony—that we do hope that Congress does not do, and one of them is, we don't want the Farm Credit System made an agency of the U.S. Government. We feel we can operate better and serve better by not being made an agency, such as FmHA is.

And second, we don't want the Government to arbitrarily block mergers. We feel like that we have shown that mergers can be accomplished and can be constructive and can be good, and those are two things that we would like to see the Congress not put in any help that they may see in their wisdom to provide.

I would like to leave you gentlemen with one thought, and it rings in my mind over so many years of the problems that agriculture has had and the ups and downs and the testimony that I have made for the Cotton Council and other ag groups and whatnot. Many years ago, one of our very learned orators and statesmen made the statement in the great agricultural depression that you can destroy our cities, and we will build them back; but if you destroy our agriculture, grass will grow in the streets of our cities.

Gentlemen, any help you can give to avoid the destruction of agriculture, Bob Carson will personally appreciate it; First South PCA will appreciate it; and I'm certain the men sitting at this table will appreciate it. Thank you for your kindness and your politeness and your generosity.

Mr. STENHOLM. I would like to ask a couple of questions before we adjourn this or turn it back to the chairman. Unfortunately, I feel a little constrained, Mr. Seaberg, to ask you questions because of the unfortunate lawsuit that we have pending in our State, and I would hope that since the parties involved—some are in this room—that a little discussion with Mr. Carson and Mr. Gilfoil might be appropriate for you, Mr. Seaberg, and for Mr. Neal and others to see what might can be worked out by talking to each others instead of at each other, but I'm restrained from asking questions. I welcome you to the testimony that you brought today, and you, Mr. Bellamy.

But I suggest—one of the questions I want to ask, what about the land banks within the fifth district? Is the same merger, the same spirit of working together and cooperation and the same results occurring in the land bank sector, or is it only in the PCA's?

Mr. CARSON. It is my understanding that the land bank has put together a study group, as they called it—we called ours a task force; they have a study group—and it's their plan, and it's in operation now, and it will take, of course, time; they have to go to the stockholders after the plan is approved and presented—to a merger of one for the entire fifth farm credit district. And it's my understanding that they would go—rather than 21 directors, as we have, they would probably have 9 directors.

Yes, sir, the land bank is moving in that direction.

Mr. STENHOLM. I'm curious. When you started in working with your 16 individual PCA's, was the initial reaction in some of those PCA boards of directors—was there opposition there? Was there some parochial nature or some individual directors of those locals that gave you some considerable opposition, or was there a spirit of cooperation all the way through?

Mr. CARSON. Initially, Mr. Stenholm, it was very anti, and I'll tell you, yours truly was probably the most anti because I was about three-fourths of the way through a merger of four associations, and I didn't have time or want to be interfered with by anybody talking to me about another one. I was very anti and I think I made people anti—not so much against mergers, but against me. I came on too strong sometimes, sir, and they just kind of backed off on account of me. But then I realized I'd made a mistake; you know, that's the hardest thing in the world, but you can say it. I was wrong. I was wrong. And I got on the wagon and then I said, "You boys hurry up; let's get something done. We haven't got much time." And with that, we moved right on. There was a lot of dissension; there was a lot of not wanting to go, but we put it all together after we talked it out.

Mr. STENHOLM. I must say, in all honestly, I'm literally amazed—but pleasantly so—at the story you brought us today, and I suggest that maybe one of the differences between the fifth district and the Texas district is the fact that you folks were in trouble, and we still find ourselves in the fortunate position of just being next door to the trouble and realizing it's coming down the line. And that might be one of the reasons why you were able to overcome some of that, besides the personalities of Mr. Gilfoil and Mr. Carson that have been expressed.

Mr. JONES of Tennessee. Thank you very much, Charley, and let me say also how much I appreciate the fact that all you gentlemen have been here today. We've had a good series of hearings and much good testimony.

Our big job now is to get through it again and take a good look at what was said so we can really get at doing something that's going to be worthwhile.

Tomorrow we meet again at 9 a.m.

I just counted the witnesses before I went out to take the telephone, and tomorrow we'll have 21 witnesses, and 1 Governor, from the State of Iowa; Mr. Naylor, the Under Secretary of Agriculture, will be here at 9:30; we will begin at 9 a.m. with Governor Bransted, and then the attorney generals at about 10 o'clock, I would presume. And from then on, the rest of the day, just like we've done today. A good group of witnesses; probably we'll not consume as much time as we've necessarily had to consume today, because the first day is always the tough day in these hearings of this sort. But I do sincerely appreciate every witness that we've had, and certainly the subcommittee for hanging in there and helping out with the big problem that we have before us and for being here as long as you have today.

And with that, if it's all right with you, Charley, if you're ready, we'll stand adjourned until tomorrow morning at 9 o'clock. Thank you very much.

[Whereupon, at 5:30 p.m., the subcommittee recessed, to reconvene at 9 a.m., Thursday, October 31, 1985.].

[Material submitted for inclusion in the record follows:]

STATEMENT OF
DONALD E. WILKINSON, GOVERNOR
FARM CREDIT ADMINISTRATION

before the

SUBCOMMITTEE ON CONSERVATION AND CREDIT

of the

HOUSE COMMITTEE ON AGRICULTURE

October 30, 1985

I. INTRODUCTION

Mr. Chairman, the financial condition of the Farm Credit System is critical. Changes are necessary to ensure that it can continue to fulfill its statutory mission and to minimize the possibility of a recurrence of this situation.

There are three areas in which action is necessary. First, expand FCA's enforcement powers and clearly define its role as an arms-length, independent Federal financial regulatory agency. Second, mandate that the System engage in self-help by pooling and managing its resources and distressed credit. And third, determine an appropriate level of public sector support for the System based upon the public policy objectives it serves.

We have come to the realization that a confluence of events and circumstances, many of which are beyond anyone's control, will stretch the financial resources of the System to their limit. Any prospects for near-term improvement or even cessation in the unrelenting economic decline in agriculture have disappeared. The most recent reports confirm further decreases in export markets and massive surplus production in 1985, practically ensuring low commodity prices for several years. We also see continued downward-spiraling of collateral values, particularly land values, and the prospect of substantial distortions in land prices from excess offerings as large groups of distressed farmers attempt to restructure their financial situations.

The challenge we face is to halt the decline and to stabilize the agricultural sector while preserving the essential elements of a farmer-owned cooperative lending network that serves the national interest.

II. HOW DID IT HAPPEN?

A. Where Agriculture is Today

Agriculture is currently undergoing an immense financial adjustment in response to a number of unfavorable -- and unanticipated -- events that have bombarded the industry since the late 1970s. Although the general economy has enjoyed a strong expansion during the past 2 1/2 years, the farm sector has been staggered by a mixture of secular problems that have reemerged after a brief respite in the 1970s and by some striking new problems. Because of these problems, agricultural exports have slumped, asset values have declined, and farm income has stagnated at levels inadequate to service some of the debt incurred by some farmers during the expansion of the 1970s. Thus, farm-business failures have increased dramatically from the low levels of the previous 2 decades. Furthermore, these problems have spilled over into rural communities. Most businesses serving the farm sector, regardless of geographic region, have encountered reduced sales and sagging profits. And as we know, the financial stress problems in agriculture have been particularly evident among rural lending institutions.

B. How Agriculture Got There

Three factors account for much of the financial stress that currently exists in agriculture.

1) The first is the erroneous expectation shared generally by farmers, lenders, and policymakers that the environment of the 1970s would continue well into the future. Certainly, the ebullient events of this decade convinced many people that the traditional problems with excess production capacity, slow demand growth, and stiff export competition were finally resolved. These views were given credibility by many expert forecasts. Scarcity rather than surplus was to be the new norm. The prospect of strong export growth and rising land values encouraged many farmers to expand their operations. Because agriculture is a capital-intensive industry, heavy borrowing was required to accomplish this goal.

   Even today, there are those who do not yet realize that this expectation is a false one. We are not simply in a temporary downturn. American agriculture is undergoing a major structural adjustment.

2) The second factor was the inflation psychology that gripped investors both here and abroad. Farmland, like many other real assets, was viewed as a store of value against inflation and became a speculative investment for some. The expectation that land would continue to appreciate pushed values to

levels that were totally unrelated to and inconsistent with its income-generating capacity. While some recognized this as an imprudent business practice, no one could forecast with certainty that inflation would be brought under control, or the timing of it.

While it is easy to criticize these credit decisions today, it should be noted that the tripling farm debt between 1970 and 1980 was in line with most of the indicators used to measure creditworthiness. For example, farm real estate assets also tripled during the decade, increasing from $215 billion in 1970 to $755 billion 10 years later. In addition, net farm income was generally favorable in the 1970s, marked by peaks of $34.4 billion in 1973 and $32.3 billion in 1979. Because of these strong income levels, the returns to equity from income in the farm sector performed well during the decade, averaging about 4.5 percent per year even with the sharp expansion in debt financing compared to 3.4 percent per year during the 1960s. Agriculture started the decade with conservative leverage overall, and it ended the decade nearly as conservative overall. Therefore, the problem of the 1970s was not that farm debt expanded too rapidly; the problem was that too much of the debt fell into too few hands.

3) The third factor was the combination of macroeconomic policies used to achieve inflation control. First was the abrupt change in monetary policy that occurred in 1979 and the deregulation of financial institutions in 1980. The

Federal Reserve permitted interest rates to rise as they may to slow the growth in the money supply to wring the inflationary spiral out of the economy. Deregulation added to interest-rate pressures as banks competed more aggressively for a limited supply of funds with new instruments that offered investors higher yields. Second was the simultaneous following of an expansive fiscal policy that necessitated both more stringent and more prolonged monetary restraint to deal with inflation.

The unprecedented increase in interest rates during the 1979-81 period accomplished the intended purpose; the back of inflation was broken more completely and rapidly than many thought possible. The annual rate of increase for the GNP deflator fell from 9.6 percent in 1981 to just under 4 percent in 1984. Although agriculture has benefited significantly from less inflation, it also suffered from major undesirable side effects. The high foreign exchange value of the dollar worsened immediate impacts of demand curtailment, while high real interest rates speeded the disappearance of inflation- induced investment. Expected income growth did not materialize and jeopardized the basis for more highly leveraged borrowers. Sharp declines in commodity prices and asset values have reduced repayment capacity and have eroded the credit quality of agricultural loans.

The rest of the story is well known. Between 1981 and 1985, U.S. farm real estate values declined about $151 billion, with over $100 billion of that drop occurring in the past year. This erosion of real estate values greatly reduces the ability of lenders to collateralize loans to cover cash-flow shortages. It also explains, perhaps more than any other factor, why farm borrowers and lenders now face their most serious crisis since the Depression. The problem focuses on the System because, unlike commercial banks, the largest share of its loan volume is in real estate mortgages.

C. The Financial Dilemma Facing Farmers

The dimensions of the financial stress problem of farmers have been widely chronicled by the press and academia over the past year. In addition, the U.S. Department of Agriculture (USDA) has used census information and results from cost-and-returns surveys to develop an excellent profile of the financial stress problem. We believe that this information accurately portrays the seriousness of the situation.

USDA reported that about one-half of the Nation's farm operators had negative cash-flows in 1984. Approximately $50 billion of farm debt is held by operators with both a negative cash-flow and a debt-to-asset ratio over 40 percent, which may be a good indication of the magnitude of the financial problem. Given the events of 1985 regarding bumper crops, falling exports, and low commodity prices, the figure can only be growing. While some analysts suggest the USDA measures of cash-flow are overly strict, conditions have deteriorated during 1985. Further, based on an examination of production credit association (PCA) data, we believe that most operators with debt-to-asset ratios above 25 percent are probably experiencing stress, especially those from the Midwest and Great Plains.

According to USDA, of the $50 billion in troubled debt, about $13 billion is held by operators with debt-to-asset ratios between 70 and 100 percent, while another $11 billion is held by those who are insolvent -- their ratios are above 100 percent. Therefore, $24 billion of the debt was probably at or approaching nonaccrual status on January 1, 1985. Farm Credit Administration staff has made projections of the likely increases in troubled debt under a pessimistic outlook for commodity prices and asset values. Based on our assumptions, the amount of troubled debt in the total agricultural sector could increase to almost $35 billion by the end of 1988 ($14 billion in the 70-100 percent category and $20.5 billion in the insolvent category).

The effect of this situation on the System in general and the Federal land banks (FLBs) in particular is profound. The USDA figures showed that about $4 billion of FLB debt is held by operators with debt-to-asset ratios between 70 and 100 percent and negative cash-flows, and $3.5 billion is owed by insolvent operators.

If land values should fall another 20 percent from January 1985 levels within the next 2-3 years, FCA estimates that a cumulative total of $13 Billion of System loans may become nonaccrual by the end of 1987. Given past collateral-recovery rates and future economic forecasts as a basis for loss projection, the restructuring and liquidation of $13 billion in loans could result in chargeoffs of $6 billion. Potential losses of this magnitude threaten the financial viability of the System. This is why contingency plans for financial assistance must be put in place at this time. (See appendix A for 37 Bank financial statements as of September 30.)

The farm-debt problem reflects the transition that agriculture is undertaking as it adjusts to the realities of less inflation, deregulation in financial markets, and the full integration into changing world food and fiber markets. Agriculture and the institutions that serve it can respond to broad changes in economic conditions given enough time. It is unlikely that agriculture can avoid making these adjustments, given the restraints on the Federal budget. So public policies are needed to buy time to allow an orderly adjustment to take place. In the absence of appropriate policy, the transition costs to the farm sector and rural communities could be immense. One of the many casualties would appear to be the System.

D. Experience of Others

Financial stress in agriculture is affecting the commercial banking sector as well. Their situation compares to the PCAs, which have also experienced significant losses. But the potential problem is less in total than the FLB exposure to dropping land values. Close to 400 agricultural banks are on the Federal Deposit Insurance Corporation's problem bank list. In the first half of the year, commercial banks charged off $520 million in farm production loans, up 85 percent from the first half of 1984. On June 30, total nonperforming loans at agricultural banks were 7.3 percent of the total portfolio, compared to 5.7 percent a year earlier. Nonaccrual loans were 5.2 percent of all loans at these banks, up from 3.8 percent last year. These difficulties result in a growing number of bank failures. Of the 82 bank failures so far this year, 49 have been agricultural banks. This figure already exceeds the total number of failures for all of last year when 78 banks failed, of which 32 were agricultural. From this information, it is clear that financial stress has permeated all lending institutions, and those with a large proportion of their portfolios in agricultural loans are no doubt retrenching.

As of January 1985, the situation facing the System appeared to be manageable within its own resources. Indeed, results of the USDA's 1984 Farm Costs and Returns Survey as enhanced by the Federal Reserve, showed that commercial bank loans were in slightly weaker hands than borrowings from the System, while as expected, the FmHA had the highest portion of loans to vulnerable farmers (see appendix B). What distinguishes the financial condition of the System today from the commercial banking sector is the rapid decline in land values and the System's domination of the farm real estate mortgage market. It now appears that

1985 alone will see land prices down nationwide as much as 10 percent; this on top of a 19-percent decline since 1981.

E. Looking Ahead in the System

Based upon FCA's analysis of the current and projected financial condition of the System, parts of it are already nonviable.

The System's competitive position may be lost well before the damage is reflected on its balance sheet. This is true because any amount of capital is adequate only so long as investors in System securities think it is. Adverse trends in financial ratios are likely to result from continued deterioration in the agricultural economy, additional loan losses, and loss of the System's ability to attract and retain financially sound borrowers.

These trends threaten the System's ability to continue to sell securities well before capital is lost. The System would likely be unable to fund itself and yet retain substantial financial resources if the financial markets lose confidence in the System's ability to manage its financial problems and become unwilling to refinance its maturing debt obligations.

The effects of a loss of market confidence would be devastating. The financial markets will be impaired with major additional cost born by other agency market entities and investors holding FCS and other agency securities.

The System is faced with a dilemma in trying to generate earnings and reserves for losses in order to halt these financial trends and retain funding capacity. The necessity is to charge higher interest rates to generate revenues necessary to meet the cost of carrying nonperforming loans and writing off losses. But higher rates exacerbate borrower flight as quality loans are refinanced at lower commercial credit rates. In addition, borrowers may leave because of the risk of loss of their equity investment in association stock, should the association fail. Those who cannot find alternatives, especially those with the weakest financial position, are further stressed by paying higher interest rates.

Compounding the System's problems is the fragmentation of its financial structure vis-a-vis its centralized fund-raising activity. The 37 System banks are jointly and severally liable to repay their consolidated notes and bonds. This access to the Nation's money markets is ensured in part through the combined financial strength and repayment record of the 37 banks. Yet, managing the capital and retained earnings of all 37 banks to maintain investor confidence and meet maturing obligations has been difficult. At best, negotiating necessary loss-sharing agreements has been time consuming and costly. And the threat always exists that one or more institutions may balk at approving them.

III. SOLVING THE PROBLEM

As I mentioned at the outset of my testimony, there are three actions that Congress must take to solve the problem. First, expand the FCA's enforcement powers and clearly define its role as an arms-length, independent Federal financial institution regulatory agency. Second, mandate that the System engage in self-help by pooling and managing its resources and distressed assets. And third, determine an appropriate level of public sector support for the System based upon the public policy objectives it serves.

A. The Role of FCA as Arms-Length Regulator

Once changes are made to FCA's statutory role as a Federal financial regulatory agency, then we can proceed to consider Federal assistance to the System with assurance that the public interest will be protected. Those changes are (1) improve the checks and balances on associations and banks; (2) enact enforcement authorities for FCA to correct unsafe and unsound banking practices; and (3) increase market discipline through accountability of management to stockholders.

Last week, we submitted legislation to the respective chairmen of the House and Senate Agriculture Committees that would extensively amend the Farm Credit Act (Act) of 1971, as amended, to reorder the FCA and equip it to meet the challenge of protecting the public interest. We take this public interest to include the protection of investors and stockholders in System institutions, as well as borrowers both now and in the future.

In making the following recommendations, we recognize the need to enhance our independence as a Federal financial regulatory agency. This recognition is based upon three assumptions. First, the public interest and that of the System do not always coincide in the short term. Insofar as the FCA is concerned, the public interest is paramount. Second, the FCA cannot guarantee the ultimate success or failure of the individual institutions of the System. This accountability lies with those who own the System through their elected boards of directors. And third, providing leadership and direction is fundamentally incompatible with the responsibility of regulating, examining, and supervising the System. The System must either provide its own leadership focus or operate without it.

1. Improve Checks and Balances on Banks and Associations.

FCA proposes to eliminate the statutory provisions authorizing and directing FCA to delegate its duties and powers to institutions of the System. This would require FCA to reassume direct responsibility for examining and supervising all System institutions. We believe this is the proper role for a Federal financial regulator. Recent experience raises serious questions regarding the reliability of bank credit reviews in stressful conditions.

The remaining authority of FCA will be governmental authority that should not be delegated to private institutions. This change is consistent with the overall purpose of the legislation we propose, which is to affirm and clarify the role of FCA as a financial institution regulatory agency and the role of System institutions as privately owned lenders.

The banks should still retain present statutory controls over the actions of the associations that are consistent with a principal/agency relationship with respect to Federal land bank associations (FLBAs), and a debtor/creditor and sole-source relationship with respect to PCAs. Of course, System institutions would be expected to continue to conduct their own internal audits.

2. Intermediate Enforcement Authorities

The present enforcement tools available to FCA are inadequate to ensure the safety and soundness of the financial institutions it supervises, regulates, and examines. Supervision by persuasion has proven ineffective.

Presently, FCA's enforcement authorities are designed to attack problems after the fact — "upon default" or after an association has "failed to meet its obligations." FCA's approval authorities permit it to attempt to forestall problems at the outset, but at the price of injecting itself into the management decisionmaking process of System institutions. There currently is no intermediate enforcement authority to correct situations as they develop.

We recommend the enactment of legislation establishing intermediate enforcement authorities for the FCA comparable to those possessed by other Federal financial regulatory agencies. These authorities will permit FCA to stop or alter a course of action that the regulator believes is unsafe, unsound, threatens the strength and stability of a financial institution, or violates the law, rules, or regulations.

Specifically, we request that FCA be granted authority to issue cease-and-desist orders and temporary cease-and-desist orders, remove or suspend officers, directors, or other persons participating in the affairs of institutions, and impose civil money penalties. These authorities would be exercised by FCA pursuant to statutory provisions requiring that notice and an opportunity for a hearing be provided to affected parties. If an order is issued, the affected party could also exercise rights to judicial review.

In February of this year, we transmitted to the respective chairmen of the House and Senate Agriculture Committees FCA's proposed legislation regarding these enforcement authorities. Since that time, the proposal has been addressed by interested parties at seven separate hearings before the House and Senate.

Based upon testimony presented at those hearings and after extensive negotiations, we recommend certain modifications to what we proposed last February. There are a number of substantive changes between the enforcement powers provisions contained in the legislation we have just submitted and provisions previously introduced in the Congress (Section 8 of S. 1598, Section 8 of H.R. 2609, and S. 466).

° Previous bills authorize enforcement proceedings against officers and directors who had "negligently" disregarded the safety and soundness of the institution. Today's bill would establish a higher standard for such actions by requiring a demonstration of "gross negligence."

° Previous bills would not require that hearings relating to enforcement matters be held in private. Today's bill would provide that such hearings would be private, except when the FCA determines that a public hearing is necessary to protect the public interest.

° Previous bills provide two bases for the imposition of civil money penalties: a) the violation of a final cease-and-desist order; or b) the violation of any provision of the Act or any FCA Regulation. Today's bill would limit the authority of FCA to impose civil money penalties to situations involving the violation of cease-and-desist orders.

° Today's bill would eliminate a provision contained in previous bills that would authorize FCA to revoke the charter of an institution if its directors had knowingly violated or permitted the violation of any provision of the Act.

- Previous bills authorize the imposition of temporary cease-and-desist orders when the activity would cause a substantial dissipation of assets or would be likely to seriously weaken the financial condition of the institution. Today's bill establishes a lower threshold for action by deleting the words "substantial" and "seriously."

- Today's bill contains a new provision that authorizes the Governor to define what constitutes an unsafe or unsound practice on an individual basis as that term is used in each enforcement proceeding.

- Today's bill contains a new provision authorizing the Governor to appoint a person to replace an officer who has been suspended or removed until judicial review of the removal is completed or until the board of the institution appoints a successor who has been approved by the Governor.

3. Increase Market Discipline and Accountability

Shareholders and investors have a right to accurate and timely information regarding the performance and condition of System institutions. Through appropriate disclosure and clear lines of accountability, the market and shareholders can effectively discipline System institutions.

FCA has proposed regulations that would require banks and associations of the System to issue annual reports and information statements to shareholders before annual meetings and to file reports of condition and performance with the FCA in accordance with prescribed accounting formats. In addition, we have designated in those proposed regulations reports to shareholders and specific portions of the reports of condition and performance as public information.

We firmly believe that shareholders of System institutions should receive accurate and timely information before electing directors so as to encourage more shareholder participation in the affairs of their institutions and to hold directors and management accountable for their actions. System banks and associations now report to their shareholders annually, but there are no standards for the form, content, and distribution of such reports. We have proposed that each System bank and association be required to issue an annual report to its shareholders within 90 days of the end of the fiscal year and to transmit a statement containing information specified in the regulation to shareholders at least 15 days before annual meetings at which directors are to be elected. The reports would be filed with FCA and available for public inspection.

The annual reports of System banks and PCAs would include financial statements audited by certified public accountants, including a copy of the accountant's opinion.

A copy of the proposed regulations and a complete description appears in the August 27, 1985, Federal Register beginning at page 34711.

Further obscuring accountability within the System are a number of statutory prior approval authorities that are vested in FCA. Such authorities are fitting of a program administrator. But for a financial institution regulator, they have the effect of injecting the regulator into the day-to-day management decisions, which are more properly the prerogatives of institution management.

We therefore propose a number of amendments to delete certain specified functions that are not consistent with FCA's role as a financial institution regulatory agency and that are more appropriately handled by the individual System institutions. The amendments also specify that when FCA is required by statute to approve transactions or activities, such approvals can be given through regulations. Such regulations would grant approval on the basis of the institution's satisfaction of or compliance with standards and criteria contained in the regulations.

Specifically, we propose to eliminate the authority for FCA to approve 1) the salary scale for employees of System institutions and the compensation of the chief executive officers of such institutions; 2) special assignment days in excess of 30 for district directors; 3) PCA lending standards, which are prescribed by the district Federal intermediate credit bank (FICB);

4) individual issues of System securities and execution of consolidated and Systemwide obligations (although FCA should retain authority to approve classes of securities and regulate their issuance).

We propose strengthening FCA's authority to regulate the preparation by System institutions and dissemination to stockholders and investors of information on the financial condition and operations of System institutions.

In view of this new authority, we propose to eliminate a number of specific powers, including the power to (1) coordinate the activities of banks in making studies of lending standards, the approval of standards, and other similar activities; (2) prescribe loan-security requirements and the loans that can only be made through prior approval; (3) coordinate, assist, and provide services associated with the effective management of System institutions; (4) prepare and disseminate information to the general public regarding the System and the merits of its securities; and (5) execute Systemwide or consolidated securities on behalf of the System institutions.

B. How The System Can Help Itself to Solve Its Problems

Losses in the System are growing at a rapid rate and threaten to overwhelm its substantial reserves and its ability to deal with problems internally.

While the System faces a potential liquidity crisis, it still retains considerable financial resources.

Because of the turmoil in the agricultural economy, many System institutions are spending the majority of their time servicing their distressed loan portfolio, rather than meeting the needs of creditworthy farmers. Given their traditional orientation toward loanmaking, rather than collecting and restructuring, System banks and associations are often ill-equipped to manage effectively a highly distressed loan portfolio, making a bad situation worse.

We propose, therefore, that the Farm Credit System Capital Corporation (FCSCC) be granted statutory authorities to implement System self-help efforts. Capitalized by System funds and staffed by highly competent workout specialists, the FCSCC's job will be to work out troubled System loans in a businesslike manner. This approach will allow the attention of the banks and associations to return to the business of making sound credit available to American agriculture.

There are four key aspects to this approach: (1) it mandates that the System pool its capital base; (2) it permits the System to pool its distressed loan assets; (3) it facilitates the restructuring and disposal of distressed assets; and (4) it permits effective management of System capital and Federal assistance. These authorities would be carried out under the supervision and control of FCA through the regulating and examining process. Within these parameters, the System can manage its own problems but FCA would have the authority to intervene to protect the public interest.

The benefits of this approach will be immediate and direct to both System institutions and their member- borrowers:

° If debt markets can be reassured that the risk of investing in System securities is small, the interest expense to System borrowers can be contained and possibly reduced after distressed loans are transferred;

° A more stable System will be under less pressure to liquidate assets to generate cash, improving the market climate in many rural areas, improving confidence, and contributing to the stabilization of farm-asset values;

° Appropriate and expert handling of distressed System assets will optimize return and minimize losses within the distressed asset portfolio, accelerating recovery of the System and minimizing cost.

The financial markets are associating greater risk with System securities than ever before, and this is reflected in the interest-rate spreads over Treasury securities that these markets demand. Without immediate action to assist the System's efforts to deal with its problems, these higher borrowing costs will have to be passed on to its borrowers, further increasing pressure on farmers at a time when many are unable to bear the burden they already have.

Also, there remains the danger that market risk perceptions will worsen further and raise the specter of default by the System.

The concept of centralizing distressed assets in a specialized organization is not unique.

The System's experience in capital assistance and asset restructuring supports the view that centralizing distressed assets and their workout will help stabilize the rural economy and improve the ability of the System institutions to return to the business of making sound credit available.

The emphasis on the size of expected System losses tends to obscure the fact that the System retains a substantial cash-flow generating capability. Not only is the System a valuable national asset, one that should not be discarded, but if provided the resources to survive this stressful period, the System will have the opportunity to return to the purposes for which it was designed.

Self-help is an essential step to preserving the System's viability as an agricultural lender and intermediator of funds from the savings-surplus sectors of the economy to the savings-deficit farm sector. System default would have a devastating, costly, and long-lasting effect on the financial infrastructure of rural America.

Experience shows that the most effective way to address the growing crisis is to pool System resources and distressed assets in a single institution. This can be implemented by the System now, with some modification to the Farm Credit Act.

Timely self-help is essential to reassure nervous debt markets and System borrowers, contain borrower interest costs, and stabilize farm-asset values.

C. Alternatives for Public Sector Support

The decision of how much Federal financial assistance to provide the Farm Credit System is one that can only be made by Congress and the Administration based upon the public policy objectives it wishes to serve. FCA's responsibility is to recommend what it believes to be the most prudent course of action to preserve the essential elements of the Farm Credit System as a stable and reliable source of competitively priced credit to creditworthy farmers, ranchers, and their cooperatives.

We therefore will outline for your consideration three alternatives for public sector support. We assume in each alternative that Congress will act to grant FCA enforcement authorities and clarify its role as an arms-length regulator, and that Congress will mandate that the System make the maximum use of its own substantial resources by augmenting the role and authorities of the Farm Credit System Capital Corporation.

ALTERNATIVE ONE: NO FINANCIAL ASSISTANCE

This approach at best will increase System funding costs as investors demand an even higher risk premium on its securities, and at worst will cause the liquidation of the Farm Credit System.

From a borrower's standpoint, it increases the uncertainty of credit availability, and raises the prospect of loss of borrower investment (B stock), increases upward pressures on interest rates, and downward pressures on land values. It also places tremendous pressure on System institutions to liquidate and dispose of its assets to generate cash to cover maturing obligations.

If no form of Federal financial assistance is provided, the impact on the financial community will be significant as well. Other agency market borrowers will likely experience an increase in funding costs as uncertainty is introduced in agency markets. Holders of System securities will experience a marked loss in value of their portfolios.

Rural communities will feel the impact as more agricultural related businesses are closed. There will be increased stress on commercial banks as asset values are destabilized.

The government will feel the impact in terms of lost revenue base and increased pressures on the Farmers Home Administration and Commodity Credit Corporation to meet farmers' credit needs.

The benefits of this alternative is that it will keep the pressure on System institutions to establish efficiency of operation, make maximum use of its resources, and operate in accordance with a strict business plan.

ALTERNATIVE TWO: BACKUP LINE OF CREDIT

This alternative is to provide the Farm Credit System with a backup line of credit from the Federal government that can be drawn up to $5 billion through a modified Governor's Revolving Fund once the System's resources have been adequately committed. This approach will negate many of the undesirable effects of alternative one. We believe this kind of backstop would provide the necessary reassurance to the financial markets to ensure the continued availability of funds. This approach also keeps a desirable level of pressure on the System to establish greater efficiencies and maximize the use of its own resources in dealing with problems without pushing individual institutions into a crisis-management position. This alternative should also stabilize interest rates on a System basis and reduce them for some institutions; alleviate borrower concerns over the loss of credit sources; and encourage a more orderly process for managing distressed situations. Under this alternative, no taxpayer funds would be committed until the clear need to do so was evident.

ALTERNATIVE THREE: UPFRONT FINANCIAL ASSISTANCE

This alternative provides direct, upfront, financial assistance combined with a contingent line of credit. However, FCA is concerned with the immediate budgetary impact this approach would have. We are also concerned that it would reduce the System's incentive to increase operating efficiency.

In conclusion, we recommend the following congressional action:

1) Grant FCA expanded intermediate enforcement authority and clarify its role as the arms-length regulator of the Farm Credit System;

2) Mandate that the System use its own resources by establishing statutory authority for the Farm Credit System Capital Corporation; and

3) Establish an adequate backup line of credit to be drawn upon as the need is demonstrated.

(Attachments follow:)

Appendix A

Testimony of
Governor Donald E. Wilkinson
Farm Credit Administration

FINANCIAL CONDITION AND PERFORMANCE
FARM CREDIT SYSTEM
QUARTER ENDING SEPTEMBER 30, 1985

Material presented herein was compiled from reports of financial condition and performance filed with FCA by Farm Credit banks for the quarter ending September 30, 1985. The information presented is as reported by the banks and reflects all revisions to initial reports received through October 25, 1985. Because further revisions are expected, the information is considered preliminary and subject to change.

FCA has neither approved nor disapproved the September 30 reports of financial condition and performance filed by FCS banks with respect to conformity to applicable accounting and reporting standards.

Appendix A does not include information on the financial condition and performance of Production Credit Associatons. PCA financial reports for the period ending September 30, 1985 are due to be filed with FCA on October 31, 1985. FLBAs report to FCA on a semiannual rather than a quarterly basis.

FCA expects to publish its Report of Financial Condition and Performance of the Farm Credit System for the third quarter of 1985 on or about December 6, 1985.

Credit Conditions as of September 30, 1985

1. Several recent economic statistics suggest that the economy is entering a period of some acceleration in growth. The 3.3-percent growth rate in real GNP for the third quarter represents an improvement over the 1.1-percent average of the first half. However, the underlying fundamentals of the current economy do not appear to support strong growth.

2. The trade deficit has continued to rise. While the rise in July was less than in June, most of the difference was a temporary decline in imports. Over the rest of this year, trade deficits are likely to continue at or above their current level.

3. Firming of the economy has been reflected in stabilizing interest rates. Additional economic strength is likely to put some upward pressure on rates.

4. The dollar has been on a downward trend since early in the year, due primarily to lower U.S. growth and declining interest rates. The dollar might be expected to firm at the prospects of a somewhat stronger economy and higher rates. In concert with Germany, Japan, Britian, and France, the U.S. has launched a coordinated program to force the dollar down.

5. Record large U.S. feed grain production materialized during the third quarter, portending a 1985/86 carryout second only to that of 1982/83, double that of 1984/85, and triple the 1983/84 level. While other domestic crops did not have record harvests, production far exceeds anticipated use, meaning record buildups of stocks and continued downward pressure on prices.

6. Red meat output continued to exceed expected levels, keeping a lid on prices and causing losses for feeders. Financial stress has meant continued liquidations, and heavy slaughter weights in anticipation of near-term price recovery has delayed such improvement.

7. U.S. agricultural export prospects continued to weaken during the third quarter. Just ended fiscal 1985 saw the dollar value slip $6 billion to $32 billion and the tonnage drop 15 million to 129 million metric tons. Further significant drops in volume and value are likely in fiscal 1986 even if the dollar continues to weaken.

8. Farm income prospects among crop producers vary greatly depending upon enrollment in the government programs. Somewhat under half the grain producers having 70-75 percent of the base program acreage are enrolled and can expect maximum deficiency payments, while those not in the program will do well if they can receive the loan rate as the market price.

9. Federal Reserve Bank surveys covering the second quarter found farm land values declining an average of 4.6 percent in the Chicago district and near 7 percent for ranchland and nonirrigated land in the Kansas City district, but values were stable to slightly mixed in the Dallas district.

10. CCC lending on the 1985 crops is expected to be record large due to depressed market prices and fairly high proportions of the program acreages enrolled, and a relatively favorable interest rate.

11. Farmers Home Administration - FmHA completed fiscal 1985 with a record level of loan obligations coupled with an inordinately high rate of debt-servicing activity.

    a) Direct lending in the operating loan (OL) program amounted to a record $3.6 billion, far exceeding the original budget of $1.9 billion.

    b) FmHA's debt set-aside program, which allows for the deferral of up to 25 percent of FmHA debt for 5 years, provided assistance to 15,794 FmHA borrowers during fiscal 1985; another 29,296 borrowers had loans that were rescheduled or reamortized. Of those applying for assistance, 10,440 were considered to have adequate cash-flow without any servicing action, 21,539 were projected to have inadequate cash-flow even if they were granted all available servicing actions, and another 4,622 were rejected on the basis of decisions made by county committees.

    c) FmHA received only 656 applications for guaranteed loans under their Debt Adjustment Program (DAP). Most of the guaranteed loan activity occurred within FmHA's regular guaranteed loan program, as $1.1 billion in regular guaranteed operating loans was obligated during fiscal 1985, compared to $55 million in DAP guaranteed loans.

    d) As of September 1, 1985, nearly 82,500 FmHA farmer borrowers were delinquent in their scheduled payments, equal to 29.8 percent of active farmer program borrowers. The delinquency rate was slightly lower than a year earlier when 30.6 percent of farmer borrowers were delinquent.

    e) For the first 11 months of fiscal 1985 (October 1984 through August 1985), 4,391 FmHA borrowers discontinued farming operations due to financial difficulties, representing 1.5 percent of all active borrowers. Over the same period last fiscal year, 6,262 borrowers were discontinued. The number declined primarily because of a considerable reduction in the number of foreclosures.

12. Commercial Banks - Commercial bank farm nonreal estate loans outstanding at the end of the second quarter were seasonally higher than at the end of the first quarter. However, for the second consecutive quarter, outstanding loans were lower than a year earlier indicating that banks are continuing a more conservative farm lending pattern.

Insured commercial banks held $40.1 billion in outstanding farm nonreal estate loans on June 30, 1985, up $1.8 billion, or 4.6 percent, from March 31, but down $1.2 billion, or 3.0 percent, from a year earlier.

13. Contributing to this year-over-year decline is a trend of reduced farmer demand for operating loans, coupled with a borrower shift, both voluntarily and involuntarily, from commercial lenders to government sources of funds (particularly FmHA). The financial performance of agricultural commercial banks continued to weaken during the second quarter, causing banks to be more cautious in their farm lending practices.

a) NET CHARGEOFFS of farm production loans at all commercial banks totaled $520 million in the first half of 1985, equal to 1.3 percent of all such loans outstanding, and up by 80 percent over chargeoffs in the first half of 1984. Historically, the fourth quarter is the most active period for bank chargeoffs, so total chargeoffs for the year will easily exceed $1 billion, compared to $900 million in 1984.

b) LOAN DELINQUENCY RATES at agricultural banks continue to rise, indicating that future chargeoff rates are likely to remain high. At the end of the second quarter, total nonperforming loans at agricultural banks were 7.3 percent of the total portfolio, compared to 5.7 percent a year earlier. Nonaccrual loans, which is the most severely delinquent category of nonperforming loans, were 5.2 percent of all loans at these banks, up from 3.8 percent last year.

c) NET EARNINGS at agricultural banks have been severely hampered by rapidly rising loan losses and higher levels of nonperforming loans. Because of this deteriorating financial performance, 12 percent of agricultural banks reported a net loss for 1984, compared with an average of only 1 percent during the 1970s. Also, in 1984, 17 percent of all agricultural banks made loan loss provisions that exceeded 2.5 percent of yearend loans outstanding.

d) The number of agricultural banks on the FDIC problem bank list continues to rise. Although agricultural banks comprise 28 percent of all commercial banks, ag banks account for 37 percent of all problem banks. Of the 975 problem commercial banks, 363 have more than 25 percent of their loan portfolios outstanding to agriculture.

e) For a growing proportion of agricultural banks, higher levels of nonperforming loans have resulted in the failure of these institutions. As of September 24, 1985, 82 commercial banks had failed, of which 49 were classified as agricultural banks representing 60 percent of the total. In all of 1984, 78 banks failed and 32, or 41 percent, were agricultural banks.

14. FARM CREDIT SYSTEM.

Large provisions for loan losses, reflecting FCS exposure to deteriorating farm loan and economic conditions, dominated third quarter financial results reported by Farm Credit banks. On a combined basis, the 37 banks reported provisions for loan losses of $538.9 million which resulted in net operating losses of $592.5 million for the third quarter. Although the combined net worth of the 37 banks remained substantial at $8.543 billion on September 30, it declined $651 million during the quarter. Total net worth declined to 10.6 percent of assets from 11.2 percent on June 30. Problems with the FLB mortgage loan portfolio accounted for the bulk of the increase in the provisions for loan losses. Third quarter financial reports for the PCAs are expected to reflect continuing problems when they become available.

Provisions for loan losses are necessary to ensure adequate allowances for loan losses. Adequate allowances for loan losses reflect risk inherent in loan portfolios and represent their effective devaluation to conform with prevailing conditions.

Provisions for loan losses totaling $509.3 million, $24.4 million and $5.2 million were reported by the FLBs, FICBs, and BCs respectively for the quarter ending September 30. These provisions brought the combined allowances for loan losses to $915.6 million for the FLBs, $51 million for the FICBs, and $122.4 million for the BCs after deduction of current loan chargeoffs. Chargeoffs reported by the FLBs for the third quarter totaled $140.3 million, compared with $1.3 million for the FICBs and $11.1 million for the BCs.

Because provisions for loan losses are charged against current income, they resulted in significant operating losses for the FLBs and FICBs on a combined basis. As a group, the 37 Farm Credit banks reported net losses totaling $592.5 million for the quarter ending September 30. Operating losses of $560.1 million and $39.5 million were reported by the FLBS and FICBs, respectively, while the BCs reported net income of $7.1 million. Third quarter operating losses translated into annualized returns on equity of -39.4 percent for the FLBs and -7.9 percent for the FICBs. The third quarter net income of the BCs represented a positive return on equity of 2.4 percent.

Nonperforming loans reported by the Farm Credit banks continued to increase and totaled $10.633 billion on September 30 compared with $9.821 billion on June 30. The portion of total nonperforming loans comprised of nonaccrual loans increased dramatically during the period, rising from $2.013 billion on June 30 to $3.533 billion on September 30. The bulk of the increase in nonaccrual loans was reported by the FLBs with nonaccruals rising from $1.854 billion to $3.297 billion on the quarter.

Operating losses resulted in declines in the combined earned net worth of the FLBs and FICBs. FLB earned net worth fell from $3.256 billion on June 30 to $2.689 billion on September 30 on a combined basis. FICB earned net worth declined from $599.9 million to $563 million on the quarter. Declining loan volume reduced FLB capital stock from $2.773 billion to $2.671 billion. Total FLB net worth reported by the FLBs declined from $6.029 billion to $5.360 billion. Total net worth reported by the FICBs declined from $2.016 billion to $1.976 billion during the quarter. Total net worth reported by the BCs declined from $1.219 billion to $1.208 billion and was due primarily to a modest decline in capital stock.

a. FEDERAL LAND BANKS.

Assets of the twelve FLBs declined 1.72 percent during the third quarter of 1985. FLBs reported assets totalling $53.280 billion at Sept. 30, 1985, down $930.7 million on the quarter. The decline centered in loans outstanding, which fell $1.802 billion. Declining loan volume was offset partially by increases in accrued interest receivable, investments in securities and acquired property.

The FLBs posted a decline in total net worth for the quarter as both earned net worth and capital stock fell. Earned net worth declined $567.2 million, 17.4 percent, to $2.689 billion. Capital stock fell $101.7 million, 3.7 percent, to end the period at $2.671 billion. Liabilities declined by $262 million, 0.5 percent, ending the quarter at $47.920 billion.

On a combined basis, the FLBs reported net operating losses of $560.1 million after provisions for losses totalling $509.8 million. The losses resulted in a combined return on assets of -4.17 percent and a return on equity of -39.4 percent. Collectively, the FLBs operated with a net interest margin of 0.75 percent for the quarter.

At Sept. 30, the debt-to-capital ratio of the FLBs was 8:94:1 on a combined basis. Total net worth comprised 10 percent of total assets.

FLB nonperforming loans comprised 12.4 percent of loans outstanding at Sept.30, 1985. Nonperforming loans held by the FLBs totalled $6.098 billion of which $3.297 billion was nonaccrual. The FLBs reported chargeoffs on loans totalling $140.3 million during the third quarter. The net impact of chargeoffs and provisions for losses from income left the FLBs with $915.6 million in allowance for loan losses at Sept. 30.

b. FEDERAL INTERMEDIATE CREDIT BANKS.

Total assets of the twelve FICBs declined $128.8 million, 0.7 percent, to $18.032 billion during the third quarter of 1985. Total loans outstanding went down $469.3 million, 2.9 percent, to $15.733 billion. Loans to PCAs declined 410.5 million, 2.7 percent, to $14.878 billion. Loans to OFIs declined from $725.9 million to $699.0 million.

Aggregate FICB liabilities declined by $88.1 million during the third quarter, falling 0.5 percent to $16.057 billion. Capital stock reported by the FICBs declined $3.9 million, 0.3 percent, to $1.413 billion. Earned net worth declined $36.9 million, 6.2 percent, to $563.0 million. Total net worth declined $40.7 million, 2.0 percent, to end the quarter at $1.976 billion.

The FICBs reported net operating losses of 39.5 million for the third quarter after making provisions for loan losses of $24.4 million. The net loss for the quarter represents an annualized return on assets of -0.87 percent and a return on equity of -7.89 percent. Collectively, the FICBs operated with a net interest margin of 2.03 percent during the third quarter.

As of Sept. 30, 1985, the debt-to-capital ratio of the FICBs stood at 8.13::1 on a combined basis while total net worth comprised 11 percent of assets.

Nonperforming loans comprised 25.3 percent of FICB loans outstanding on Sept. 30. Some $3.983 billion of the $15.733 in FICB loan volume was nonperforming of which $104.7 million was in nonaccrual status. The FICBs reported loan losses totaling $1.2 million during the quarter leaving the combined allowance for loan losses at $51.0 million on Sept. 30, 1985.

c. BANKS FOR COOPERATIVES.

Assets of the thirteen Banks for Cooperatives declined $634.2 million, 6.3 percent,
during the third quarter of 1985, to $9.435 billion. Loans outstanding fell $592.1 million, 7.1 percent, to $7.751 billion.

Aggregate BC liabilities declined 7.0 percent on the quarter, to $8.228 billion. Total BC net worth fell 1.0 percent during the quarter, to $1.208 billion from $1.219 billion. Capital stock declined 1.3 percent to $832.4 million. Earned net worth declined slightly from $375.9 million to $375.1 million.

The BCs reported net income for the quarter of $7.1 million after making provisions for possible loan losses totaling $5.2 million. Net income translated to an annualized return on assets of 0.29 percent and a return on equity of 2.35 percent. Collectively, the thirteen BCs operated with a net interest margin of 1.58 percent on the quarter.

As of Sept. 30, 1985, the debt-to-capital ratio of the BCs was 6.81:1 on a combined basis. Total net worth represented 13 percent of assets.

Nonperforming loans accounted for 7.1 percent of BC loans outstanding at Sept. 30, 1985 with $552.1 million in nonperforming status and $7.751 billion in total loans. Nonaccrual loans accounted for $130.5 million of total nonperforming loans. Collectively, the BCs reported loan losses totaling $11.1 million for the quarter and ended the period with allowances for loan losses totaling 122.4 million.

Summary of Condition and Income
Components of the Farm Credit System
at and for the Quarter Ending September 30, 1985

1.

	Summary of Condition September 30, 1985				
	13 BCs	12 FICBs	12 FLBs	FLBAs(1)	PCAs(2)
	- - millions of dollars - -				
Loans - total principal	7,751.1	15,733.2	49,254.9		
Performing	7,199.0	11,749.6	43,156.5		
Restructured	14.4	612.5	10.3		
Other restructured & reduced rates	47.6	0	17.1		
Other high risk	359.6	3,266.4	2,773.7		
Nonaccrual	130.5	104.7	3,297.3		
Less: Allowance for losses	122.4	51.0	915.6		
Net loans	7,628.7	15,682.2	48,339.3		
Cash & investments in securities	1,519.9	1,733.0	2,041.4		
Net acquired property	6.3	13.2	674.7		
Other assets net of adjustments	280.4	603.9	2,224.6		
Total assets	9,435.3	18,032.3	53,280.0		
Total liabilities	8,227.8	16,056.6	47,920.3		
Capital stock & participation certificates	832.4	1,412.6	2,671.1		
Earned net worth	375.1	563.0	2,688.5		
Total net worth	1,207.5	1,975.7	5,359.6		

(1) FLBAs report to FCA on a semiannual basis rather than a quarterly basis. The next FLBA reports to FCA will be at and for the 6 months ending December 31, 1985.

(2) Quarterly PCA reports to FCA for the period ending September 30, 1985, are due in the agency on October 31, 1985.

Components may not add to exact totals due to rounding.

2.

Summary of Income and Expenses
Quater Ending September 30, 1985

	13 BCs	12 FICBs	12 FLBs	FLBAs(1)	PCAs(2)
		- - millions of dollars - -			
Total Interest Income	232.4	452.4	1,435.9		
Less: Total Interest Expense	194.4	364.1	1,339.1		
Net Interest Income	38.0	88.3	96.8		
Less: Provision for Loan Losses	5.2	24.4	509.3		
Net Interest Income after Provision	32.8	63.9	-412.5		
Plus: Other Income	1.0	76.4	3.2		
Less: Other Expenses	26.7	179.7	150.8		
Net Income	7.1	-39.5	-560.1		

(1) FLBAs report to FCA on a semiannual basis rather than a quarterly basis. The next FLBA reports to FCA will be at and for the 6 months ending December 31, 1985.

(2) Quarterly PCA reports to FCA for the period ending September 30, 1985, are due in the agency on October 31, 1985.

Components may not add to exact totals due to rounding.

3.

Additional Financial Information
at and for the Quarter Ending September 30, 1985

	13 BCs	12 FICBs	12 FLBs	FLBAs(1)	PCAs(2)
		- - Three Months Ending September 30, 1985 - -			
Return on assets (%)	0.29	-0.87	-4.17		
Return on equity (%)	2.35	-7.89	-39.35		
Net interest margin (%)	1.58	2.03	0.75		
Net chargeoffs on loans ($ millions)	11.1	1.3	140.3		
Capital-to-assets ratio	0.13	0.11	0.10		
Debt-to-capital ratio	6.81	8.13	8.94		

Source: Reports of financial condition and performance.

(1) FLBAs report to FCA on a semiannual basis rather than a quarterly basis. The next FLBA reports to FCA will be at and for the 6 months ending December 31, 1985.

(2) Quarterly PCA reports to FCA for the period ending September 30, 1985, are due in the agency on October 31, 1985.

Components may not add to exact totals due to rounding.

Table 4

FLB Loan Performance
September 30, 1985

	Farm Credit District												
	1	2	3	4	5	6	7	8	9	10	11	12	Total
	Percent of Total Loans												
1. Performing	96.5	95.2	92.5	81.8	84.3	88.5	85.5	84.6	82.5	98.0	88.7	88.3	87.6
2. Formally restructured	0	*	*	*	0	*	*	*	0.1	0.1	0	0	*
3. Informally restructured	0	*	0	0	0		0.2	*	0	*	0	0	*
4. Other High Risk	2.5	3.4	4.8	5.6	12.5	4.1	4.4	4.8	7.8	1.6	7.2	7.8	5.6
5. Nonaccrual	1.0	1.3	2.6	12.6	3.2	7.4	9.9	10.6	9.7	0.2	4.2	3.9	6.7
VOLUME ($ million)	995.8	2,184.3	5,315.2	4,319.7	2,753.3	4,884.0	7,251.3	5,574.4	4,968.0	2,764.7	4,596.3	3,647.9	49,254.9
	Percent of Loan Numbers												
1. Performing	98.1	97.3	96.4	94.4	96.9	95.2	93	91.9	93.1	98.5	93.8	94.5	94.8
2. Formally restructured	0	*	*	*	*	0	*	*	*	*	*	0	*
3. Informally restructured	0	*	0	0	0	0	0	*	0	*	0	0	*
4. Other High Risk	1.5	2.4	3.1	3.4	2.6	4.8	5.1	5.9	4.2	1.4	5.0	4.9	3.9
5. Nonaccrual	0.4	0.3	0.5	2.2	0.5	A	2.0	2.2	2.7	0	1.1	0.6	1.2
NUMBER (000)	17.3	35.6	90.6	61.6	35.2	58.7	87.8	68.9	63.2	39.4	23.9	38.9	621.2

* Less than 0.1 percent
A Not available
Percentages may not sum to 100.0 due to rounding.

Table 6

FICB Loan Performance
September 30, 1985

	Farm Credit District												
	1	2	3	4	5	6	7	8	9	10	11	12	Total
	Percent of Total Loans												
1. Performing	99.8	85.2	66.8	99.7	97.8	87.9	71.6	18.5	73.2	91.4	80.9	51.3	74.7
2. Formally restructured	0	0	2.6	0.1	0	0	8.7	0	2.9	0	11.8	0	3.9
3. Informally restructured	0	0	0	0	0	0	0	0	0	0	0	0	0
4. Other High Risk	0	14.6	30.0	0	2.0	11.8	19.5	79.7	23.6	8.2	6.0	47.4	20.8
5. Nonaccrual	0.2	0.2	0.6	0.2	0.2	0.3	0.3	1.9	0.2	0.4	1.3	1.3	0.7
VOLUME ($ million)	604.31	715.9	1,515.7	1,424.7	711.1	1,079.6	2,702.7	1,472.9	939.3	1,102.4	2631.5	832.8	15,733.2

Percentages may not sum to 100.0 due to rounding.

Table 7

Banks for Cooperatives Loan Performance
September 30, 1985

	Farm Credit District													
	1	2	3	4	5	6	7	8	9	10	11	12	CBC	Total
						Percent of Total Loans								
1. Performing	99.6	92.4	77.4	99.4	99.0	90.6	93.3	78.5	97.5	83.7	85.4	89.1	95.8	92.9
2. Formally restructured	0	0.1	0	0	0	0	0	0	0	5.8	0	0	0.2	0.2
3. Informally restructured	0	0	0	0	0	0	0	0.1	0	0.6	8.6	0	0	0.6
4. Other High Risk	0	5.0	15.9	0.3	0.2	8.8	6.3	20.0	2.1	6.1	0	10.3	2.5	4.6
5. Nonaccrual	0.4	2.5	6.8	0.3	0.8	0.6	0.4	1.4	0.4	3.7	6.0	0.6	1.6	1.7
VOLUME ($ million)	151.7	66.8	267.7	425.4	298.2	367.4	995.4	419.8	426.3	144.5	540.5	319.4	3,327.9	7,751.0
						Percent of Loan Numbers								
1. Performing	99.0	44.48	80.6	98.7	98.2	95.2	95.7	90.6	97.6	84.4	97.4	90.9	93.9	94.5
2. Formally restructured	0	11.1	0	0	0	0	0	0	0	3.2	2.0	0	1.0	0.3
3. Informally restructured	0	0	0	0	0	0	0	0	0	1.3	0	0	0	0.1
4. Other High Risk	0	33.3	14.9	1.3	0.9	3.6	3.6	7.1	2.0	8.4	0	7.4	3.0	3.9
5. Nonaccrual	1.0	11.1	4.5	0	0.9	1.2	0.7	2.1	0.4	2.6	0.7	1.7	2.1	1.1
NUMBER (000)	105	9	67	301	217	248	704	436	461	154	153	175	99	3,129

Percentages may not sum to 100.0 due to rounding.

Exhibit 1-A.1
Federal Land Banks
Statement of Condition
Combined Totals
September 30, 1985
($ 000 Omitted)

Loans: Unmatured Principal	$ 45,340,695
Unmatured Extensions	19,468
Delinquent Principal and Advances	575,306
Loans in Process of Closing	22,092
Nonaccrual Loans	3,297,307
Accrued Interest Receivable on Loans	2,633,388
Gross Loan Items	51,888,257
Less: Allowance for Losses	915,640
Less: Deferred Proceeds of Loans	95,722
Less: Future Payment Funds	372,213
Less: Advance Payments	346,376
Less: Unamortized Loan Fees	19,143
Less: Unapplied Loan Payments	53,790
Net Loan Items	50,085,373
Cash	54,345
Investments: U.S. Government Securities (Par)	161,340
Securities Government Supervised Institutions (Par)	149,135
Other Securities and Federal Funds	1,683,548
Investment in DBC Bankers Acceptances (Par)	0
Unamortized Premium or Discount (Net)	-7,810
Unamortized Defer Gain/Loss Security Sales (Net)	870
Total Investment in Securities	1,987,083
Notes Receivable Farm Credit Banks and Other	141,383
Accounts Receivable - Other FC Banks	84,307
Accrued Interest Receivable - Other Farm Credit Banks	1,477
Accrued Interest Receivable - Investments	22,250
Acquired Property	757,980
Less: Allowance for Losses	83,322
Less: Accumulated Depreciation	0
Net Acquired Property	674,658
Land, Buildings, and Equipment	156,814
Less: Accumulated Depreciation	34,770
Net Land, Buildings, and Equipment	122,044
Prepaid Expenses and Other Assets	107,061
Total Assets	$ 53,279,980

Exhibit 1-A.2
Federal Land Banks
Statement of Condition
Combined Totals
September 30, 1985
($ 000 Omitted)

Drafts Outstanding	$ 3,985
Notes Payable: FLBAs	475,764
Other Farm Credit Banks	0
Consolidated Systemwide Notes	1,238,242
Commercial Banks and Other	239,006
Securities Sold Under Agreement to Repurchase	125,434
Total Notes Payable	2,078,445
Accounts Payable	96,788
Accrued Interest Payable	1,460,566
Miscellaneous Trust Accounts	58,162
Unmatured Consolidated and Systemwide Bonds	44,293,745
Less: Consolidated Bonds Owned	222,000
Net Consolidated and System Bonds Outstanding	44,071,745
Unmatured Farm Credit Investment Bonds Outstanding	99,153
Matured Farm Credit Investment Bonds Outstanding	0
Other Liabilities	51,493
Total Liabilities	47,920,336
Capital Stock: Class B - FLBAs	2,522,786
Class C - FLBAs	0
Participation Certificates - FLBAs	148,355
Total Capital Stock	2,671,140
Earned Net Worth: Legal Reserve	1,681,369
Surplus Reserve	128,010
Earned Surplus	879,125
Total Earned Net Worth	2,688,504
Total Net Worth	5,359,644
Liabilities and Net Worth	$ 53,279,980

Exhibit 1-B.1
Federal Land Banks
Combined Statement of Income
September 30, 1985
($ 000 Omitted)

Loan Interest Income: Mortgage Loans	$ 1,371,372
Notes Receivable Other Farm Credit Banks	1,858
Sales Contracts (Net)	318
Penalty Other Interest Income	24,528
Total Interest Income from Loans	1,398,076
Income From Investments (Net)	37,870
Compensation Income - Participations Sold	0
Appraisal and Loan Service Fees	2,741
Financially Related Services	361
Other Operating Income	71
Gross Earnings	1,439,120
Notes and Bonds Expense: Cost of Bonds	1,297,227
Interest on Notes Payable	35,380
Interest on Future Payment Funds	6,493
Total Cost of Borrowed Funds	1,339,100
Compensation Expense - Participations Purchased	0
Operating Expense	66,113
Total Expenses	1,405,213
Net Gain (Loss) from Operations	33,906
Other Add/Deduct: Gain (Loss) - Sale of Investment	-15
Income (Expense) - Office Building or Premises	-50
Income (Expense) - Land/Buildings (Investment)	5
Income (Expense) - Acquired Property	-1,843
Gain (Loss) - Disposition of Acquired Property	1,091
Provision for Losses - Acquired Property	-75,525
Income (Expense) - Mineral Reservations	6,777
Interest on Investments - Buildings/Premises	212
Other Gains (Losses)	-15,353
Total Other Additions and Deductions	-84,705
Net Gain (Loss) Before Provision for Losses	-50,799
Provision for Losses on Loans	509,318
Net Earnings	$ -560,117

Exhibit I-C.1
Federal Land Banks
Statement of Condition
September 30, 1985
($ 000 Omitted)

	Springfield	Baltimore	Columbia	Louisville	Jackson	St. Louis
Loans: Unmatured Principal	$ 980,781	$ 2,142,437	$ 5,142,965	$ 3,746,603	$ 2,645,301	$ 4,483,337
Unmatured Extensions	0	0	6,375	0	33	1,931
Delinquent Principal and Advances	4,464	10,550	25,566	27,046	17,173	36,315
Loans in Process of Closing	808	2,104	155	1,672	3,320	275
Nonaccrual Loans	9,720	29,204	140,105	544,370	87,522	362,128
Accrued Interest Receivable on Loans	20,162	58,271	275,437	239,348	154,173	262,947
Gross Loan Items	1,015,935	2,242,565	5,590,604	4,559,039	2,907,521	5,146,933
Less: Allowance for Losses	14,735	20,035	53,464	48,323	72,493	82,456
Less: Deferred Proceeds of Loans	1,422	6,677	22,793	3,126	878	1,507
Less: Future Payment Funds	0	0	0	0	0	0
Less: Advance Payments	279	22,735	56,179	54,075	62,394	46,592
Less: Unamortized Loan Fees	0	0	0	0	1,504	0
Less: Unapplied Loan Payments	1,480	0	7,152	20,778	11,456	14,022
Net Loan Items	998,018	2,193,118	5,451,015	4,432,737	2,758,794	5,002,375
Cash	2,791	4,107	223	6,658	5,600	5,220
Investments: U.S. Government Securities (Par)	0	1,365	0	24,000	22,325	2,500
Securities Government Supervised Institutions (Par)	0	0	30,625	15,555	12,410	0
Other Securities and Federal Funds	66,000	153,751	80,153	83,787	45,971	249,257
Investment in DBC Bankers Acceptances (Par)	0	0	0	0	0	0
Unamortized Premium or Discount (Net)	0	-8	-37	-847	4	-79
Unamortized Defer Gain/Loss Security Sales (Net)	0	0	282	299	0	290
Total Investment in Securities	66,000	155,107	111,022	122,792	80,710	251,966
Notes Receivable Farm Credit Banks and Other	5,087	8,992	277	21,205	22,000	511
Accounts Receivable	2,228	1,154	70	47,273	208	250
Accrued Interest Receivable - Other Farm Credit Banks	35	57	19	74	135	0
Accrued Interest Receivable - Investments	138	3,512	1,010	984	1,297	960
Acquired Property	3,233	6,112	74,523	59,168	181,307	72,263
Less: Allowance for Losses	43	157	6,303	1,125	33,890	0
Less: Accumulated Depreciation	0	0	0	0	0	0
Net Acquired Property	3,190	5,955	68,220	58,043	147,417	72,263
Land, Buildings, and Equipment	16,036	12,875	7,340	10,048	10,538	11,220
Less: Accumulated Depreciation	4,057	2,617	3,350	4,572	1,425	2,467
Net Land, Buildings, and Equipment	11,979	10,257	3,989	5,476	9,113	8,753
Prepaid Expenses and Other Assets	2,234	4,561	9,469	15,654	6,140	6,565
Total Assets	$ 1,091,700	$ 2,386,821	$ 5,645,314	$ 4,710,896	$ 3,031,415	$ 5,348,862

Exhibit I-C.2
Federal Land Banks
Statement of Condition
September 30, 1985
($ 000 Omitted)

	Springfield	Baltimore	Columbia	Louisville	Jackson	St. Louis
Drafts Outstanding	$ 12	$ -89	$ 249	$ 452	$ 303	$ 158
Notes Payable: FLBAs	14,782	57,945	40,974	49,315	3,145	19,104
Other Farm Credit Banks	0	0	0	0	0	0
Consolidated Systemwide Notes	67,398	73,789	0	0	23,875	193,218
Commercial Banks and Other	0	15,357	50,188	35,386	22,031	36,996
Securities Sold Under Agreement to Repurchase	0	0	0	4,875	0	0
Total Notes Payable	82,179	147,092	91,162	89,576	49,051	249,317
Accounts Payable	7,836	1,633	599	567	382	376
Accrued Interest Payable	27,137	57,348	162,749	136,561	85,921	146,062
Miscellaneous Trust Accounts	616	7,218	6,205	1,342	569	3,763
Unmatured Consolidated and Systemwide Bonds	849,925	1,802,100	4,721,388	4,177,791	2,649,800	4,419,500
Less: Consolidated Bonds Owned	0	0	47,000	100,000	25,000	0
Net Consolidated and System Bonds Outstanding	849,925	1,802,100	4,674,388	4,077,791	2,624,800	4,419,500
Unmatured Farm Credit Investment Bonds Outstanding	0	99,153	0	0	0	0
Matured Farm Credit Investment Bonds Outstanding	0	0	0	0	0	0
Other Liabilities	976	1,176	4,919	4,397	4,102	4,135
Total Liabilities	968,680	2,115,629	4,940,272	4,310,686	2,765,129	4,823,311
Capital Stock: Class B - FLBAs	53,768	104,538	249,331	235,719	135,451	263,845
Class C - FLBAs	0	0	0	0	0	0
Participation Certificates - FLBAs	6,269	14,100	39,429	9,049	13,691	5,369
Total Capital Stock	60,037	118,639	288,760	244,768	149,142	269,214
Earned Net Worth: Legal Reserve	62,191	76,686	216,915	134,697	77,803	160,885
Surplus Reserve	0	4,500	0	9,000	0	0
Earned Surplus	791	71,367	199,368	11,744	39,340	95,452
Total Earned Net Worth	62,982	152,553	416,283	155,442	117,143	256,337
Total Net Worth	123,020	271,192	705,063	400,209	266,286	525,551
Liabilities and Net Worth	$ 1,091,700	$ 2,386,821	$ 5,645,314	$ 4,710,896	$ 3,031,415	$ 5,348,862

Exhibit 1-C.3
Federal Land Banks
Statement of Condition
September 30, 1985
($ 000 Omitted)

	St. Paul	Omaha	Wichita	Texas	Sacramento	Spokane
Loans: Unmatured Principal	$ 6,447,983	$ 4,806,231	$ 4,361,868	$ 2,747,111	$ 4,363,773	$ 3,472,305
Unmatured Extensions	9,011	2,108	0	11	0	0
Delinquent Principal and Advances	79,703	174,541	125,020	1,246	38,875	34,807
Loans in Process of Closing	0	0	1,639	9,668	2,451	0
Nonaccrual Loans *	714,647	591,496	479,477	6,666	191,232	140,739
Accrued Interest Receivable on Loans	335,452	380,793	266,548	142,689	263,366	234,203
Gross Loan Items	7,586,795	5,955,170	5,234,552	2,907,392	4,859,697	3,882,054
Less: Allowance for Losses	150,781	187,696	151,100	43,415	53,074	38,067
Less: Deferred Proceeds of Loans	9,800	3,682	1,117	9,374	33,587	1,758
Less: Future Payment Funds	0	76,214	116,949	68,059	35,676	75,315
Less: Advance Payments	80,328	97	11,463	12,224	9	0
Less: Unamortized Loan Fees	17,638	0	0	0	0	0
Less: Unapplied Loan Payments	-8,321	3,866	2,536	-1,582	1,058	1,367
Net Loan Items	7,336,570	5,683,615	4,951,387	2,775,903	4,736,294	3,765,547
Cash	8,593	8,500	1,787	3,692	965	6,209
Investments: U.S. Government Securities (Par)	25,400	13,000	50,000	5,750	17,000	0
Securities Government Supervised Institutions (Par)	18,819	5,000	10,000	0	41,726	15,000
Other Securities and Federal Funds	213,356	171,804	153,865	230,873	162,633	72,100
Investment in DBC Bankers Acceptances (Par)	0	0	0	0	0	0
Unamortized Premium or Discount (Net)	-3,262	-11	-1	-609	-1,985	-964
Unamortized Defer Gain/Loss Security Sales (Net)	0	0	0	0	0	0
Total Investment in Securities	254,312	189,792	213,863	236,013	219,372	86,134
Notes Receivable Farm Credit Banks and Other	17,569	6,630	13,499	0	33,587	12,025
Accounts Receivable	18,132	4,212	5,039	1,229	3,883	779
Accrued Interest Receivable - Other Farm Credit Banks	24	341	568	0	214	11
Accrued Interest Receivable - Investments	2,881	3,095	1,925	4,741	1,296	413
Acquired Property	101,195	84,034	72,616	3,331	67,987	32,212
Less: Allowance for Losses	7,337	21,604	4,441	0	4,781	3,641
Less: Accumulated Depreciation	0	0	0	0	0	0
Net Acquired Property	93,858	62,430	68,175	3,331	63,206	28,571
Land, Buildings, and Equipment	15,168	8,350	18,813	9,864	6,996	29,567
Less: Accumulated Depreciation	4,857	3,800	1,834	910	1,866	3,014
Net Land, Buildings, and Equipment	10,312	4,550	16,980	8,954	5,129	26,553
Prepaid Expenses and Other Assets	9,222	8,235	16,784	5,967	7,302	14,927
Total Assets	$ 7,751,472	$ 5,971,399	$ 5,290,006	$ 3,039,829	$ 5,071,249	$ 3,941,169

Exhibit 1-C.4
Federal Land Banks
Statement of Condition
September 30, 1985
($ 000 Omitted)

	St. Paul	Omaha	Wichita	Texas	Sacramento	Spokane
Drafts Outstanding	$ 0	$ 0	$ 748	$ 0	$ 937	$ 1,216
Notes Payable: FLBAs	77,979	5,566	30,237	95,490	24,238	56,988
Other Farm Credit Banks	0	0	0	0	0	0
Consolidated Systemwide Notes	271,329	19,976	69,567	165,623	218,848	134,620
Commercial Banks and Other	52,027	425	0	0	273	26,323
Securities Sold Under Agreement to Repurchase	19,689	17,925	60,638	22,307	0	0
Total Notes Payable	421,025	43,891	160,442	283,420	243,359	217,931
Accounts Payable	92	47,823	37,301	163	25	141
Accrued Interest Payable	213,661	170,008	129,799	85,367	139,196	106,756
Miscellaneous Trust Accounts	26,367	9,041	2,863	1,390	-1,996	785
Unmatured Consolidated and Systemwide Bonds	6,203,400	5,290,000	4,423,793	2,361,350	4,206,700	3,187,998
Less: Consolidated Bonds Owned	0	50,000	0	0	0	0
Net Consolidated and System Bonds Outstanding	6,203,400	5,240,000	4,423,793	2,361,350	4,206,700	3,187,998
Unmatured Farm Credit Investment Bonds Outstanding	0	0	0	0	0	0
Matured Farm Credit Investment Bonds Outstanding	0	0	0	0	0	0
Other Liabilities	5,663	5,089	7,994	3,044	4,094	5,903
Total Liabilities	6,870,208	5,515,853	4,762,940	2,734,735	4,592,316	3,520,729
Capital Stock: Class B - FLBAs	359,623	286,483	242,668	141,794	258,948	190,619
Class C - FLBAs	0	0	0	0	0	0
Participation Certificates - FLBAs	20,936	8,037	12,597	11,005	2,039	5,832
Total Capital Stock	380,559	294,519	255,265	152,800	260,987	196,450
Earned Net Worth: Legal Reserve	291,562	161,027	197,191	74,844	113,050	114,516
Surplus Reserve	61,310	0	0	47,500	0	5,700
Earned Surplus	147,834	0	74,610	29,950	104,896	103,774
Total Earned Net Worth	500,706	161,027	271,801	152,294	217,946	223,990
Total Net Worth	881,265	455,546	527,066	305,093	478,933	420,440
Total Liabilities and Net Worth	$ 7,751,472	$ 5,971,399	$ 5,290,066	$ 3,039,829	$ 5,071,249	$ 3,941,169

Exhibit 1-D.1
Federal Land Banks
Statement of Income
Three Months Ending September 30, 1985
($ 000 Omitted)

	Springfield	Baltimore	Columbia	Louisville	Jackson	St. Louis
Loan Interest Income: Mortgage Loans	$ 29,772	$ 61,976	$ 152,102	$ 104,432	$ 77,288	$ 131,850
Notes Receivable Other Farm Credit Banks	73	154	0	217	408	21
Sales Contracts (Net)	0	0	0	0	0	0
Penalty and Other Interest Income	496	666	1,230	291	2,008	412
Total Interest Incomeron Loans	30,342	62,796	153,332	104,940	79,704	132,283
Income from Investments (Net)	1,405	3,319	2,111	2,498	1,575	3,538
Compensation Income - Participations Sold	0	0	0	0	0	0
Appraisal and Loan Service Fees	0	1	772	0	275	261
Financially Related Services	0	10	0	57	73	11
Other Operating Income	28	20	0	0	0	0
Gross Earnings	31,774	66,146	156,215	107,496	81,627	136,093
Notes and Bonds Expense: Cost of Bonds	23,548	54,843	137,951	123,999	76,949	126,453
Interest on Notes Payable	1,874	2,553	2,351	1,633	1,172	42
Interest on Future Payment Funds	2	0	0	0	0	0
Total Cost of Borrowed Funds	25,424	57,396	140,302	125,632	78,122	126,495
Compensation Expense - Participations Purchased	0	0	0	0	0	0
Operating Expense	3,184	4,228	7,921	5,153	5,218	8,190
Total Expenses	28,608	61,624	148,223	130,785	83,340	134,685
Net Gain (Loss) from Operations	3,166	4,521	7,992	-23,289	-1,712	1,408
Other Add/Deduct: Gain (Loss) - Sale of Investment	0	-15	0	0	0	0
Income (Expense) Office Building and Premises	0	1	13	0	0	0
Income (Expense) Land/Buildings (Investment)	0	0	2	0	-7	0
Income (Expense) - Acquired Property	1	-32	-7	134	357	-60
Gain (Loss) - Disposition of Acquired Property	5	9	248	-615	118	26
Provision for Losses - Acquired Property	0	-47	-2,268	-9,028	-28,558	-11,230
Income (Expense) - Mineral Reservations	0	1	0	1	2,375	366
Interest on Investment - Buildings/Premises	25	128	59	0	0	0
Other Gains (Losses)	-974	-2,078	-5,278	-5,441	32,366	-4,979
Total Other Additions and Deductions	-944	-2,036	-7,233	-14,951	6,649	-15,879
Net Gain (Loss) before Provision for Losses	2,221	2,484	758	-38,240	4,937	-14,471
Provision for Losses	-260	-262	20,650	35,220	39,161	35,000
Net Earnings	$ 2,482	$ 2,747	$ -19,891	$ -73,461	$ -34,223	$ -49,471

Exhibit 1-D.2
Federal Land Banks
Statement of Income
Three Months Ending September 30, 1985
($ 000 Omitted)

	St. Paul	Omaha	Wichita	Texas	Sacramento	Spokane
Loan Interest Income: Mortgage Loans	$ 205,531	$ 166,598	$ 129,141	$ 78,016	$ 131,195	$ 103,472
Notes Receivable Other Farm Credit Banks	171	3	302	1	484	23
Sales Contracts (Net)	0	231	73	0	0	14
Penalty and Other Interest Income	3,646	3,929	7,899	86	1,153	2,711
Total Interest Income from Loans	209,347	170,762	137,416	78,102	132,832	106,220
Income from Investments (Net)	4,418	4,210	4,572	4,584	3,777	1,865
Compensation Income - Participations Sold	0	0	0	0	0	0
Appraisal and Loan Service Fees	404	16	0	42	964	6
Financially Related Services	32	178	0	0	0	0
Other Operating Income	3	16	3	0	1	0
Gross Earnings	214,204	175,181	141,991	82,728	137,574	108,091
Notes and Bonds Expense: Cost of Bonds	181,543	158,963	128,077	68,600	122,823	93,478
Interest on Notes Payable	7,296	1,226	4,491	5,308	3,734	3,700
Interest on Future Payment Funds	0	2,433	0	1,891	0	2,167
Total Cost of Borrowed Funds	188,839	162,622	132,568	75,798	126,557	99,345
Compensation Expense - Participations Purchases	0	0	0	0	0	0
Operating Expense	10,276	8,184	8,317	2,318	-1,617	4,742
Total Expenses	199,115	170,806	140,885	78,116	124,939	104,088
Net Gain (Loss) from Operations	15,090	4,375	1,106	4,612	12,634	4,003
Other Add/Deduct: Gain (Loss) - Sale of Investment	0	0	0	0	0	0
Income (Expense) Office Building and Premises	0	11	-2	0	0	-72
Income (Expense) Land/Buildings (Investment)	0	3	0	0	0	9
Income (Expense) - Acquired Property	3	-72	-1,191	-82	-284	-603
Gain (Loss) - Disposition of Acquired Property	0	-47	1,288	-25	-6	94
Provision for Losses - Acquired Property	-1,623	-18,778	-381	0	-3,118	-486
Income (Expense) - Mineral Reservations	1,306	38	1,511	782	63	334
Interest on Investment - Buildings/Premises	0	0	0	0	0	0
Other Gains (Losses)	-7,272	-6,157	-4,976	-2,567	-4,512	-3,476
Total Other Additions and Deductions	-7,587	-25,005	-3,753	-1,894	-7,859	-4,203
Net Gain (Loss) before Provision for Losses	7,502	-20,629	-2,647	2,717	4,775	-200
Provision for Losses	83,983	177,253	115,884	600	2,300	-209
Net Earnings	$ -76,480	$ -197,882	$ -118,531	$ 2,117	$ 2,475	$ 9

EXHIBIT 1-E.1
FEDERAL LAND BANKS
NONPERFORMING LOANS, CHARGEOFFS, AND FINANCIAL RATIOS
SEPTEMBER 30, 1985

	SPRINGFIELD	BALTIMORE	COLUMBIA	LOUISVILLE[1]	JACKSON	ST. LOUIS[1]
Nonperforming Loans ($ millions)	34.7	104.4	397.0	787.0	286.2	706.1
Formally Restructured	0	0.3	1.1	1.4	0.1	0
Other Restructured & Reduced Rate	0	0.3	0	0	0	0
Other High Risk	25.0	74.6	255.8	241.2	198.6	344.0
Nonaccrual	9.7	29.2	140.1	544.4	87.5	362.1
Net Loan Chargeoffs ($ millions)	a	0.9	4.7	22.0	8.4	30.0
Selected Ratios						
Return on Assets (%)	0.90	0.46	(1.40)	(6.04)	(4.45)	(3.68)
Return on Equity (%)	7.90	4.06	(11.08)	(65.98)	(47.64)	(35.65)
Net Interest Margin (%)	2.38	1.49	1.13	(1.69)	0.45	0.77
Capital to Assets	0.11	0.11	0.12	0.08	0.09	0.10
Debt to Capital	7.87	7.80	7.00	10.77	10.38	9.18

Components may not add to totals due to rounding.
* Indicates less than $50,000
a Indicates net recovery of less than $50,000
1 Indicates preliminary data, revisions expected

EXHIBIT 1-E.2
FEDERAL LAND BANKS
NONPERFORMING LOANS, CHARGEOFFS, AND FINANCIAL RATIOS
SEPTEMBER 30, 1985

	ST. PAUL	OMAHA	WICHITA[1]	TEXAS	SACRAMENTO	SPOKANE
Nonperforming Loans ($ millions)	1,052.3	860.2	867.4	55.5	521.5	426.0
Formally Restructured	*	1.5	2.5	3.4	0	0
Other Restructured & Reduced Rate	15.8	0.5	0	0.5	0	0
Other High Risk	321.9	266.7	385.4	44.9	330.3	285.3
Nonaccrual	714.6	591.5	479.5	6.7	191.2	140.7
Net Loan Chargeoffs ($ millions)	11.8	34.7	19.1	(0.3)	9.3	(0.3)
Selected Ratios						
Return on Assets (%)	(3.93)	(12.87)	(8.84)	0.28	0.20	0
Return on Equity (%)	(33.11)	(140.05)	(79.52)	2.79	2.06	0.01
Net Interest Margin (%)	1.42	0.90	0.78	0.93	0.86	0.97
Capital to Assets	0.11	0.08	0.10	0.10	0.09	0.11
Debt to Capital	7.80	12.11	9.04	8.96	9.59	8.37

Components may not add to totals due to rounding.
* Indicates less than $50,000
1 Indicates preliminary data, revisions expected

Exhibit 3-A.1

Federal Intermediate Credit Banks

Statement of Condition

Combined Totals

September 30, 1985

($000 Omitted)

Loans and Discounts: PCAs	$ 14,877,905
Other Financing Institutions	699,047
Participation Loans - PCAs	19,246
Other Participations	28,472
Sales Contracts, Notes, Etc.	3,857
Nonaccrual Loans	104,662
Accrued Interest Receivable on Loans	382,879
Gross Loan and Discount Items	16,116,067
Less: Allowance for Losses	51,077
Less: Unapplied Loan Payments	21,191
Net Loan and Discouunt Items	16,043,869
Cash	58,468
Investments: U.S. Government Securities (Par)	109,338
Securities Government Supervised Institutions (Par)	115,952
Other Securities and Federal Funds	1,455,703
Investment in DBC Bankers Acceptances (Par)	0
Unamortized Premium or Discount (Net)	-7,716
Unamortized Defer Gain/Loss Security Sales (Net)	1,288
Total Investment in Securities	1,674,564
Investments in PCAs: Paid in Surplus (Net)	600
Class A Stock	25,563
Class B Stock	0
Class D Stock	20,646
Total Investments in PCAs	46,808
Notes Receivable Farm Credit Banks and Other	78,388
Accounts Receivable	9,742
Accrued Interest Receivable - Other Farm Credit Banks	394
Accrued Interest Receivable - Investments	15,576
Acquired Property: Investments and Operations	15,491
Less: Allowance for Losses	2,296
Less: Accumulated Depreciation	2
Net Acquired Property	13,193
Land, Buildings, and Equipment	78,213
Less: Accumulated Depreciation	13,735
Net Land, Buldings, and Equipment	64,478
Prepaid Expenses and Other Assets	26,847
Total Assets	$ 18,032,328

Exhibit 3-A.2
Federal Intermediate Credit Banks
Statement of Condition
Combined Totals
September 30, 1985
($000 Omitted)

Notes Payable: Other Farm Credit Banks	$ 779
Consolidated Systemwide Notes	2,828,922
Commercial Banks and Other	108,771
Securities Sold Under Agreement to Repurchase	14,908
Total Notes Payable	2,953,380
Accounts Payable	126,712
Accrued Interest Payable	386,555
Unmatured Consolidated and Systemwide Bonds	12,628,405
Less: Consolidated Bonds Owned	88,199
Net Consolidated and System Bonds Outstanding	12,540,206
Unmatured Farm Credit Investment Bonds Outstanding	28,795
Matured Farm Credit Investment Bonds Outstanding	0
Other Liabilities	20,992
Total Liabilities	16,056,640
Capital Stock: Class B Stock - PCAs	1,343,810
Participation Certificates	68,839
Total Capital Stock	1,412,649
Earned Net Worth: Surplus Reserved	63,067
Surplus Unallocated	30,913
Legal Reserve	447,785
Reserve for Contingencies - Unallocated	33,197
Undistributed Earnings	-11,921
Total Earned Net Worth	563,039
Total Net Worth	1,975,688
Total Liabilities and Net Worth	$ 18,032,328

Exhibit 3-B.1

Federal Intermediate Credit Banks
Statement of Condition
Combined Totals
September 30, 1985
($000 Omitted)

Loan Interest Income: Loans and Discounts	$	422,901
Sales Contracts		96
Notes Receivable Other Farm Credit Banks		549
Other Interest Income		43
Total Interest Income from Loans		423,589
Income From Investments (Net)		28,806
Other Operating Income		76,376
Gross Earnings		528,772
Notes and Bonds Expense: Cost of Bonds		315,101
Interest on Notes Payable		48,997
Total Cost of Borrowed Funds		364,098
Compensation Expense - Participations Purchased		14
Operating Expense		25,720
Total Expenses		389,832
Net Gain (Loss) from Operations		138,940
Other Add/Deduct: Gain (Loss) - Sale of Investment		304
Income (Expense) - Office Building or Premises		11
Income (Expense) - Land/Buildings (Investment)		3
Income (Expense) - Acquired Property		-87
Gain (Loss) - Disposition of Acquired Property		28
Provision for Losses - Acquired Property		-449
Income (Expense) - Mineral Reservations		26
Other Gains (Losses)		-153,839
Total Other Additions and Deductions		-154,006
Net Gain (Loss) Before Provision for Losses		-15,066
Provision for Losses on Loans		24,425
Net Earnings	$	-39,491

Exhibit 3-C.1
Federal Intermediate Credit Banks
Statement of Condition
September 30, 1985
($000 Omitted)

	Springfield	Baltimore	Columbia	Louisville	Jackson	St. Louis
Loans and Discounts: FCAs	$ 602,683	$ 665,194	$ 1,505,039	$ 1,414,844	$ 580,804	$ 1,053,535
Other Financing Institutions	633	44,180	1,788	6,450	115,037	22,911
Participation Loans - FCAs	0	5,037	0	0	13,941	267
Other Participations	0	0	0	0	0	0
Sales Contracts, Notes, Etc.	0	0	0	0	0	0
Nonaccrual Loans	1,033	1,520	8,869	3,425	1,408	2,924
Accrued Interest Receivable on Loans	6	5,704	14,283	84,550	17,571	26,483
Gross Loan and Discount Items	604,354	721,636	1,529,979	1,509,269	728,762	1,106,119
Less: Allowance for Losses	0	766	5,966	11,881	3,527	3,359
Less: Unapplied Loan Payments	0	0	0	0	0	9,293
Net Loan and Discount Items	604,354	720,869	1,524,013	1,497,388	725,235	1,093,468
Cash	2,556	2,075	285	6,679	456	8,996
Investments: U.S. Government Securities (Par)	0	1,770	0	8,000	0	0
Securities Government Supervised Institutions (Par)	0	0	5,600	23,499	0	0
Other Securities and Federal Funds	64,000	139,257	100,716	51,664	25,479	133,767
Investment in DBC Bankers Acceptances (Par)	0	0	0	0	0	0
Unamortized Premium or Discount (Net)	0	-13	-52	-561	0	0
Unamortized Defer Gain/Loss Security Sales (Net)	0	0	271	253	0	0
Total Investment in Securities	64,000	141,013	106,535	82,853	25,479	133,767
Investments in FCAs: Paid in Surplus (Net)	0	0	0	0	0	600
Class A Stock	0	0	0	11,640	2,589	7,333
Class B Stock	0	0	0	0	0	0
Class D Stock	0	0	4,376	0	8,000	0
Total Investments in FCAs	0	0	4,376	11,640	10,589	7,933
Notes Receivable Farm Credit Banks and Other	5,183	11,018	0	20,000	23,601	0
Accounts Receivable	237	98	345	3,539	50	1,214
Accrued Interest Receivable - Other Farm Credit Banks	35	23	0	36	20	0
Accrued Interest Receivable - Investments	107	3,571	858	952	51	584
Acquired Property: Investments and Operations	0	0	306	0	51	546
Less: Allowance for Losses	0	0	45	0	0	0
Less: Accumulated Depreciation	0	0	0	0	0	0
Net Acquired Property	0	0	260	0	51	546
Land, Buildings, and Equipment	1,135	0	2,539	4,032	8,157	10,353
Less: Accumulated Depreciation	234	0	989	819	611	2,006
Net Land, Buildings, and Equipment	901	0	1,550	3,213	7,497	8,347
Prepaid Expenses and Other Assets	606	968	1,885	4,354	4,121	2,095
Total Assets	$ 677,979	$ 879,636	$ 1,640,108	$ 1,630,655	$ 795,150	$ 1,256,949

Exhibit 3-C.2
Federal Intermediate Credit Banks
Statement of Condition
September 30, 1985
($000 Omitted)

	Springfield	Baltimore	Columbia	Louisville	Jackson	St. Louis
Notes Payable: Other Farm Credit Banks	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Consolidated Systemwide Notes	117,072	95,625	30,976	39,847	102,593	152,000
Commercial Banks and Other	0	5,362	12,224	11,748	5,267	8,226
Securities Sold Under Agreement to Repurchase	0	0	0	4,875	0	0
Total Notes Payable	117,072	100,988	43,200	56,470	107,860	160,225
Accounts Payable	6,017	754	1,689	585	187	59
Accrued Interest Payable	14,334	17,840	37,556	37,810	14,926	25,871
Unmatured Consolidated and Systemwide Bonds	480,015	651,000	1,335,250	1,267,827	565,051	916,000
Less: Consolidated Bonds Owned	0	0	38,000	0	0	0
Net Consolidated and System Bonds Outstanding	480,015	651,000	1,297,250	1,267,827	565,051	916,000
Unmatured Farm Credit Investment Bonds Outstanding	0	28,783	0	0	0	0
Matured Farm Credit Investment Bonds Outstanding	0	0	0	0	0	0
Other Liabilities	39	216	1,173	251	114	1,306
Total Liabilities	617,477	799,580	1,380,868	1,362,963	688,138	1,103,461
Capital Stock: Class B Stock - PCAs	42,209	48,187	170,812	199,213	67,826	103,388
Participation Certificates	118	3,626	178	613	9,410	1,708
Total Capital Stock	42,327	51,813	170,991	199,826	77,236	105,096
Earned Net Worth: Surplus Reserved	4,593	4,177	3,701	5,273	4,105	4,819
Surplus Unallocated	367	431	2,092	3,153	1,332	2,880
Legal Reserve	13,214	17,031	70,252	57,205	20,950	34,855
Reserve for Contingencies - Unallocated	0	2,739	1,714	0	0	4,409
Undistributed Earnings	0	3,863	10,490	2,255	3,388	1,430
Total Earned Net Worth	18,175	28,242	88,249	67,886	29,776	48,393
Total Net Worth	60,502	80,555	259,240	267,713	107,012	153,488
Total Liabilities and Net Worth	$ 677,979	$ 879,636	$ 1,640,108	$ 1,630,655	$ 795,150	$ 1,256,949

Exhibit 3-C.3
Federal Intermediate Credit Banks
Statement of Condition
September 30, 1985
($000 Omitted)

	St. Paul	Omaha	Wichita	Texas	Sacramento	Spokane
Loans and Discounts: FCAs	$ 2,605,400	$ 1,367,830	$ 852,929	$ 915,789	$ 2,523,712	$ 790,146
Other Financing Institutions	90,039	77,533	82,150	180,934	73,955	3,438
Participation Loans - FCAs	0	0	0	0	0	0
Other Participations	0	0	0	0	0	28,472
Sales Contracts, Notes, Etc.	0	68	1,999	1,789	0	0
Nonaccrual Loans	7,337	27,507	2,258	3,859	33,799	10,723
Accrued Interest Receivable on Loans	76,110	42,675	8,306	8,902	88,871	9,418
Gross Loan and Discount Items	2,778,886	1,515,613	947,642	1,111,273	2,720,337	842,196
Less: Allowance for Losses	3,876	2,642	11,127	1,394	1,200	5,268
Less: Unapplied Loan Payments	9,871	410	0	1,617	0	0
Net Loan and Discount Items	2,765,139	1,512,561	936,514	1,108,262	2,719,137	836,928
Cash	11,968	1,918	3,257	2,137	14,095	4,045
Investments: U.S. Government Securities (Par)	65,000	6,300	10,000	3,268	10,000	5,000
Securities Government Supervised Institutions (Par)	34,537	1,000	18,500	0	11,000	21,817
Other Securities and Federal Funds	226,067	140,513	44,743	335,946	134,106	59,444
Investment in DBC Bankers Acceptances (Par)	0	0	0	0	0	0
Unamortized Premium or Discount (Net)	-4,286	35	279	-2,017	-55	-1,040
Unamortized Defer Gain/Loss Security Sales (Net)	422	107	0	236	0	0
Total Investment in Securities	321,739	147,955	73,522	337,431	155,050	85,220
Investments in FCAs: Paid in Surplus (Net)	0	0	0	0	0	0
Class A Stock	0	0	0	0	0	4,000
Class B Stock	0	0	0	0	0	0
Class D Stock	0	0	7,250	1,020	0	0
Total Investments in FCAs	0	0	7,250	1,020	0	4,000
Notes Receivable Farm Credit Banks and Other	6,732	987	21	0	846	10,000
Accounts Receivable	1,442	3,142	449	139	525	-576
Accrued Interest Receivable - Other Farm Credit Banks	0	176	61	0	8	34
Accrued Interest Receivable - Investments	2,378	1,615	1,237	1,427	2,215	581
Acquired Property: Investments and Operations	0	2,054	0	3,471	9,064	0
Less: Allowance for Losses	0	431	0	1,819	0	0
Less: Accumulated Depreciation	0	0	0	2	0	0
Net Acquired Property	0	1,622	0	1,650	9,064	0
Land, Buildings, and Equipment	13,132	3,853	17,896	9,726	6,167	1,223
Less: Accumulated Depreciation	3,856	1,083	1,337	637	1,854	259
Net Land, Buildings, and Equipment	9,276	2,770	16,559	9,089	4,313	964
Prepaid Expenses and Other Assets	3,678	1,686	1,455	3,031	3,177	1,793
Total Assets	$ 3,122,352	$ 1,674,431	$ 1,040,325	$ 1,464,186	$ 2,908,430	$ 942,988

Exhibit 3-C.4
Federal Intermediate Credit Banks
Statement of Condition
September 30, 1985
($000 Omitted)

	St. Paul	Omaha	Wichita	Texas	Sacramento	Spokane
Notes Payable: Other Farm Credit Banks	$ 779	$ 0	$ 0	$ 0	$ 0	$ 0
Consolidated Systemwide Notes	531,911	267,661	99,737	451,347	748,572	191,582
Commercial Banks and Other	23,233	747	0	8,761	24,296	8,908
Securities Sold Under Agreement to Repurchase	0	7,255	0	2,778	0	0
Total Notes Payable	555,924	275,662	99,737	462,886	772,867	200,489
Accounts Payable	584	105,189	9,109	32	134	3,233
Accrued Interest Payable	73,150	35,934	24,523	25,531	59,158	19,922
Unmatured Consolidated and Systemwide Bonds	2,175,524	1,153,896	754,459	840,653	1,859,680	629,050
Less: Consolidated Bonds Owned	194	50,000	0	0	0	5
Net Consolidated and System Bonds Outstanding	2,175,330	1,103,896	754,459	840,653	1,859,680	629,045
Unmatured Farm Credit Investment Bonds Outstanding	12	0	0	0	0	0
Matured Farm Credit Investment Bonds Outstanding	0	0	0	0	0	0
Other Liabilities	12,023	346	715	2,889	553	1,368
Total Liabilities	2,817,022	1,521,028	888,543	1,331,990	2,692,392	854,058
Capital Stock: Class B Stock - PCAs	204,593	135,681	97,226	57,557	147,251	69,868
Participation Certificates	11,081	7,779	11,738	13,764	4,706	4,116
Total Capital Stock	215,675	143,460	108,964	71,321	151,957	73,984
Earned Net Worth: Surplus Reserved	7,049	6,069	5,257	7,593	4,541	5,890
Surplus Unallocated	1,818	1,244	1,507	14,007	1,260	821
Legal Reserve	70,275	48,538	36,055	23,636	49,906	5,868
Reserve for Contingencies - Unallocated	10,512	0	2,435	7,139	4,249	0
Undistributed Earnings	0	-45,906	-2,434	8,500	4,127	2,367
Total Earned Net Worth	89,655	9,943	42,819	60,875	64,081	14,946
Total Net Worth	305,329	153,403	151,782	132,196	216,038	88,930
Total Liabilities and Net Worth	$ 3,122,352	$ 1,674,431	$ 1,040,325	$ 1,464,186	$ 2,908,430	$ 942,988

Exhibit 3-D.1
Federal Intermediate Credit Banks
Statement of Income
Three Months Ending September 30, 1985
($000 Omitted)

	Springfield	Baltimore	Columbia	Louisville	Jackson	St. Louis
Loan Interest Income: Loans and Discounts	$ 15,179	$ 17,575	$ 45,255	$ 35,408	$ 17,602	$ 26,499
Sales Contracts	0	0	0	0	0	0
Notes Receivable Other Farm Credit Banks	71	168	0	58	74	0
Other Interest Income	1	0	0	0	0	0
Total Interest Income from Loans	15,251	17,743	45,255	35,466	17,676	26,499
Income From Investments (Net)	1,240	2,859	1,814	1,603	211	1,722
Other Operating Income	155	4	0	0	0	0
Gross Earnings	16,665	20,605	47,069	37,069	17,887	28,221
Notes and Bonds Expense: Cost of Bonds	11,205	15,578	32,822	29,182	13,149	20,171
Interest on Notes Payable	2,219	1,728	1,104	601	1,333	3,029
Total Cost of Borrowed Funds	13,424	17,307	33,925	29,782	14,481	23,200
Compensation Expense - Participations Purchased	0	0	0	0	0	0
Operating Expense	1,391	1,434	1,627	2,214	1,404	2,489
Total Expenses	14,815	18,741	35,553	31,997	15,885	25,689
Net Gain (Loss) from Operations	1,830	1,864	11,517	5,072	2,002	2,532
Other Add/Deduct: Gain (Loss) - Sale of Investment	0	0	0	0	367	0
Income (Expense) - Office Building or Premises	20	0	0	0	-7	0
Income (Expense) - Land/Buildings (Investment)	0	0	0	0	0	0
Income (Expense) - Acquired Property	0	0	1	0	0	-1
Gain (Loss) - Disposition of Acquired Property	0	0	0	0	0	0
Provision for Losses - Acquired Property	0	0	-41	0	0	-35
Income (Expense) - Mineral Reservations	0	0	0	0	0	0
Other Gains (Losses)	-661	-743	-1,934	-2,928	-797	-2,503
Total Other Additions and Deductions	-641	-743	-1,975	-2,928	-438	-2,540
Net Gain (Loss) Before Provision for Losses	1,189	1,120	9,541	2,143	1,563	-8
Provision for Losses on Loans	0	249	2,762	4,814	302	0
Net Earnings	$ 1,189	$ 871	$ 6,778	$ -2,670	$ 1,261	$ -8

Exhibit 3-D.2
Federal Intermediate Credit Banks
Statement of Income
Three Months Ending September 30, 1985
($000 Omitted)

	St. Paul	Omaha	Wichita	Texas	Sacramento	Spokane
Loan Interest Income: Loans and Discounts	$ 76,234	$ 42,873	$ 25,898	$ 27,707	$ 69,086	$ 23,587
Sales Contracts	0	2	55	39	0	0
Notes Receivable Other Farm Credit Banks	64	1	0	0	38	74
Other Interest Income	0	17	0	0	26	0
Total Interest Income from Loans	76,298	42,892	25,953	27,746	69,149	23,661
Income From Investments (Net)	5,878	2,042	1,368	5,209	3,245	1,616
Other Operating Income	5	76,208	4	0	0	0
Gross Earnings	82,181	121,142	27,325	32,955	72,394	25,278
Notes and Bonds Expense: Cost of Bonds	58,763	28,899	19,000	20,981	48,535	16,817
Interest on Notes Payable	9,049	4,594	1,832	6,928	13,358	3,224
Total Cost of Borrowed Funds	67,811	33,493	20,832	27,909	61,893	20,040
Compensation Expense - Participations Purchased	0	0	0	0	0	14
Operating Expense	4,420	2,197	2,606	1,747	2,467	1,722
Total Expenses	72,232	35,690	23,438	29,656	64,360	21,777
Net Gain (Loss) from Operations	9,949	85,452	3,887	3,299	8,034	3,501
Other Add/Deduct: Gain (Loss) - Sale of Investments	-62	0	0	0	0	0
Income (Expense) - Office Building or Premises	0	0	0	0	0	0
Income (Expense) - Land/Buildings (Investment)	0	3	0	0	0	0
Income (Expense) - Acquired Property	0	-7	0	-12	-65	0
Gain (Loss) - Disposition of Acquired Property	0	0	0	28	0	0
Provision for Losses - Acquired Property	0	-383	0	11	0	0
Income (Expense) - Mineral Reservations	0	0	0	26	0	0
Other Gains (Losses)	-17,748	-120,978	-1,246	-1,465	-2,824	-1
Total Other Additions and Deductions	-17,811	-121,368	-1,246	-1,413	-2,890	-1
Net Gain (Loss) Before Provision for Losses	-7,862	-35,915	2,639	1,886	5,143	3,499
Provision for Losses on Loans	1,459	1,992	10,692	55	600	1,5000
Net Earnings	$ -9,321	$ -37,907	$ -8,052	$ 1,831	$ 4,543	$ 1,999

EXHIBIT 3-E.1

FEDERAL INTERMEDIATE CREDIT BANKS
NONPERFORMING LOANS, CHARGEOFFS, AND FINANCIAL RATIOS
SEPTEMBER 30, 1985

	SPRINGFIELD	BALTIMORE	COLUMBIA	LOUISVILLE	JACKSON	ST. LOUIS
Nonperforming Loans ($ millions)	1.0	106.2	503.7	4.3	15.3	130.8
Formally Restructured	0	0	40.0	0.9	0	0
Other Restructured & Reduced Rate	0	0	0	0	0	0
Other High Risk	0	104.7	454.8	0	13.9	127.9
Nonaccrual	1.0	1.5	8.9	3.4	1.4	2.9
Net Loan Chargeoffs ($ millions)	0	0	0.9	0	#	#
Selected Ratios						
Return on Assets (%)	0.71	0.40	1.58	(0.66)	0.68	0
Return on Equity (%)	7.68	4.38	10.60	(3.97)	4.73	(0.2)
Net Interest Margin (%)	1.83	1.55	3.11	1.93	1.92	1.74
Capital-to-Assets	0.09	0.09	0.16	0.16	0.13	0.12
Debt-to-Capital	10.21	9.99	5.33	5.09	6.43	7.19

Less than $50,000 net recovery.

EXHIBIT 3-E.2

FEDERAL INTERMEDIATE CREDIT BANKS
NONPERFORMING LOANS, CHARGEOFFS, AND FINANCIAL RATIOS
SEPTEMBER 30, 1985

	ST. PAUL	OMAHA	WICHITA	TEXAS	SACRAMENTO	SPOKANE
Nonperforming Loans ($ millions)	767.6	1,201.0	251.5	94.3	502.5	405.4
Formally Restructured	234.1	0	27.3	0	310.3	0
Other Restructured & Reduced Rate	0	0	0	0	0	0
Other High Risk	526.2	1,173.5	221.9	90.4	158.4	394.7
Nonaccrual	7.3	27.5	2.3	3.9	33.8	10.7
Net Loan Chargeoffs ($ millions)	0	0.4	0	#	0	0
Selected Ratios						
Return on Assets (%)	(1.18)	(8.83)	(2.99)	0.51	0.63	0.79
Return on Equity (%)	(11.99)	(87.88)	(20.46)	5.55	8.50	9.09
Net Interest Margin (%)	1.88	2.86	2.49	1.44	1.53	2.23
Capital-to-Assets	0.10	0.09	0.15	0.09	0.07	0.09
Debt-to-Capital	9.23	9.92	5.85	10.08	12.46	9.60

Less than $50,000 net recovery

Exhibit 5-A.1
Banks for Cooperatives
Combined Statement of Condition
September 30, 1985
($000 Omitted)

Loans to Cooperatives: Seasonal Loans	$2,739,731
Term	4,554,347
Commodity	153,295
Acceptances	89,823
Subtotal	7,537,197
Less: Participations	0
Less: Acceptances Discounted to Other FC Banks	0
Less: Unapplied Loan Payments	6,956
Less: Unearned Income (Acceptances)	1,109
Total Loans to Cooperative Associations	7,529,132
Nonaccrual Loans	130,477
Sales Contracts, Notes, Etc.	91,441
Accrued Interest Receivable on Loans	153,548
Gross Loan Items	7,904,598
Less: Allowance for Losses	122,383
Net Loan Items	7,782,215
Cash	19,904
Investments: U.S. Government Securities (Par)	6,800
Securities Government Supervised Institutions (Par)	41,954
Other Securities and Federal Funds	1,454,841
Unamortized Premium or Discount (Net)	-3,629
Total Investment in Securities	1,499,965
Investments in Central Bank for Cooperatives	0
Investments in Other Banks for Cooperatives	0
Investments in DBC Bankers Acceptances (Net)	0
Notes Receivable Farm Credit Banks and Other	33,860
Accounts Receivable	11,816
Accrued Interest Receivable - Other Farm Credit Banks	1,001
Accrued Interest Receivable - Investments	7,900
Acquired Property	6,678
Less: Accumulated Depreciation	87
Less: Allowance for Losses	263
Net Acquired Property	6,328
Land, Buildings, and Equipment	52,838
Less: Accumulated Depreciation	9,140
Net Land, Buildings, and Equipment	43,699
Customers Liability on Acceptances Outstanding	0
Prepaid Expenses and other Assets	28,635
Total Assets	$9,435,322

Exhibit 5-A.2
Banks for Cooperatives
Combined Statement of Condition
September 30, 1985
($000 Omitted)

Notes Payable: Other Farm Credit Banks	$ 219,360
Consolidated Systemwide Notes	3,435,846
Commercial banks and Other	24,470
Securities Sold Under Agreement to Repurchase	25,068
Total Notes Payable	3,704,745
Accounts Payable	22,004
Accrued Interest Payable	127,738
Unmatured Consolidated and Systemwide Bonds	4,248,881
Less: Consolidated Bonds Owned	35,000
Net Consolidated and System Bonds Outstanding	4,213,881
Unmatured Farm Credit Investment Bonds Outstanding	148,123
Matured Farm Credit Investment Bonds Outstanding	0
Capital Stock and Equities Called For Retirement	1,775
Bankers Liability on Acceptances Outstanding	0
Other Liabilities	9,559
Total Liabilities	8,227,825
Capital Stock: Class B - All	475
Class C - District Banks	0
Class C - Cooperative Associations	792,763
Class D - All	1,127
Other - Cooperative Associations	1,530
Class C - Subscribed - Cooperative Associations	36,484
Class C - Subscribed - District Banks	0
Total Capital Stock	832,378
Earned Net Worth: Surplus Reserved	88,111
Surplus Allocated to Cooperative Associations	198,810
Surplus Allocated to District Banks	0
Surplus Unallocated	38,710
Undistributed Earnings	49,488
Total Earned Net Worth	375,119
Total Net Worth	1,207,497
Total Liabilities and Net Worth	$9,435,322

Exhibit 5-B.1
Banks for Cooperatives
Combined Statement of Income
September 30, 1985
($000 Omitted)

Loan Interest Income: Cooperative Associations	$196,928
Sales Contracts	2,281
Notes Receivable Other Farm Credit Banks	373
Other Interest Income	890
Total Interest Income from Loans	200,472
Income from Investments (Net)	31,934
Compensation Income - Participations Sold	0
Appraisal and Loan Service Fees	3
Financially Related Services	25
Customers Draft Accepted Fees	0
Letters of Credit Issued Fees	975
Income from Distribution of Earnings of Central BC	0
Income from Dist. of Earnings of Other District Banks	0
Gross Earnings	233,408
Notes and Bonds Expense: Cost of Bonds	$123,197
Interest on Notes Payable	71,174
Total Cost of Borrowed Funds	194,371
Compensation Expense - Participations Purchased	0
Operating Expense	16,417
Total Expenses	210,788
Net Gain (Loss) from Operations	22,620
Other Add/Deduct: Gain (Loss) - Sale of Investment	-126
Income (Expense) Acquired Property	10
Gain (Loss) - Disposition of Acquired Property	1
Provision for Losses - Acquired Property	0
Income (Expense) Office Building or Premises	102
Income (Expense) Land/Buildings (Investment)	-2
Other Gains (Losses)	-9,744
Other Income (Expense)	61
Total Other Additions and Deductions	-9,701
Net Gain (Loss) Before Provision for Losses	12,919
Provision for Losses	-5,240
Net Earnings before Income Taxes	7,677
Less: Federal and Other Income Taxes	548
Net Earnings	$7,129

Exhibit 5-C.1
Banks for Cooperatives
Statement of Condition
September 30, 1985
($000 Omitted)

	Springfield	Baltimore	Columbia	Louisville	Jackson	St. Louis
Loans to Cooperatives: Seasonal Loans	$120,729	$91,617	$ 39,739	$142,811	$159,258	$162,446
Term	259,643	97,472	399,037	521,227	755,847	277,215
Commodity	0	0	46,449	0	0	24,425
Acceptances	0	0	0	0	4,500	0
Subtotal	380,372	189,089	485,226	664,038	919,604	464,086
Less: Participations	229,308	124,025	249,203	239,516	620,135	101,743
Less: Acceptances Discounted to Other FC Banks	0	0	0	0	0	0
Less: Unapplied Loan Payments	0	0	0	384	3,561	0
Less: Unearned Income (Acceptances)	0	0	0	0	32	0
Total Loans to Cooperative Associations	151,064	65,064	236,022	424,138	295,876	362,344
Nonaccrual Loans	629	1,648	18,082	1,239	2,359	2,206
Sales Contracts, Notes, Etc.	39	87	13,612	0	0	2,860
Accrued Interest Receivable on Loans	3,751	-1,046	-1,487	-1,210	6,636	7,549
Gross Loan Items	155,484	65,751	266,228	424,166	304,872	374,959
Less: Allowance for Losses	2,022	1,900	4,938	7,711	4,837	10,137
Net Loan Items	153,461	63,851	261,290	416,456	300,035	364,821
Cash	223	-149	279	1,146	4,993	1,974
Investments: U.S. Government Securities (Par)	0	0	0	0	1,000	0
Securities Government Supervised Institutions (Par)	0	0	0	10,000	3,000	4,000
Other Securities and Federal Funds	14,000	19,893	14,400	53,799	22,404	61,966
Unamortized Premium or Discount (Net)	0	0	0	89	-16	-22
Total Investment in Securities	14,000	19,893	14,400	63,888	26,388	65,942
Investments in Central Bank for Cooperatives	19,870	8,313	24,208	24,837	43,746	16,999
Investments in Other Banks for Cooperatives	244	0	578	0	0	0
Investments in DBC Bankers Acceptances (Net)	0	0	0	0	0	0
Notes Receivable Farm Credit Banks and Other	2,895	5,116	675	9	30,000	5,957
Accounts Receivable	4,406	1,072	319	245	899	1,861
Accrued Interest Receivable - Other Farm Credit Banks	11	29	4	1	355	0
Accrued Interest Receviable - Investments	36	543	56	983	418	452
Acquired Property	0	0	0	0	0	86
Less: Accumulated Depreciation	0	0	0	0	0	0
Less: Allowance for Losses	0	0	0	0	0	0
Net Acquired Property	0	0	0	0	0	86
Land, Buildings, and Equipment	1,135	0	430	3,122	6,969	5,215
Less: Accumulated Depreciation	234	0	253	902	576	899
Net Land, Buildings, and Equipment	901	0	177	2,220	6,394	4,326
Customers Liability on Acceptances Outstanding	0	0	0	0	0	0
Prepaid Expenses and other Assets	282	522	5,498	2,033	1,843	1,020
Total Assets	$196,330	$99,189	$307,483	$511,818	$415,072	$463,440

Exhibit 5-C.2
Banks for Cooperatives
Statement of Condition
September 30, 1985
($000 Omitted)

	Springfield	Baltimore	Columbia	Louisville	Jackson	St. Louis
Notes Payable: Other Farm Credit Banks	$ 0	$ 0	$ 4,078	$ 4,000	$ 7,555	$ 0
Consolidated Systemwide Notes	49,755	19,858	64,718	27,745	82,069	41,578
Commercial banks and Other	0	571	0	0	2,165	3,339
Securities Sold Under Agreement to Repurchase	0	0	0	10,200	0	0
Total Notes Payable	49,755	20,429	68,796	41,945	91,789	44,917
Accounts Payable	2,737	318	3,600	3,643	387	1,326
Accrued Interest Payable	2,533	1,451	4,829	10,180	5,586	8,168
Unmatured Consolidated and Systemwide Bonds	88,010	53,962	175,480	321,850	169,000	307,000
Less: Consolidated Bonds Owned	0	0	10,000	0	0	0
Net Consolidated and System Bonds Outstanding	88,010	53,962	165,480	321,850	169,000	307,000
Unmatured Farm Credit Investment Bonds Outstanding	0	3,233	2,120	32,751	25,640	6,050
Matured Farm Credit Investment Bonds Outstanding	0	0	0	0	0	0
Capital Stock and Equities Called For Retirement	0	0	0	0	0	0
Bankers Liability on Acceptances Outstanding	0	0	0	0	0	0
Other Liabilities	194	45	588	343	234	47
Total Liabilities	143,230	79,438	245,413	410,712	292,635	367,510
Capital Stock: Class B - All	0	0	0	0	0	0
Class C - District Banks	0	239	95	52	179	624
Class C - Cooperative Associations	34,964	13,327	39,560	68,041	94,758	62,611
Class D - All	0	0	0	0	0	0
Other - Cooperative Associations	0	0	0	0	0	0
Class C - Subscribed - Cooperative Associations	3,132	0	3,772	255	204	3,211
Class C - Subscribed - District Banks	0	0	0	0	0	56
Total Capital Stock	38,096	13,566	43,426	68,348	95,141	66,503
Earned Net Worth: Surplus Reserved	4,419	2,576	4,371	5,180	3,628	6,154
Surplus Allocated to Cooperative Associations	9,090	190	8,779	22,584	19,694	16,746
Surplus Allocated to District Banks	0	5	18	21	49	175
Surplus Unallocated	644	2,756	3,964	691	1,912	2,731
Undistributed Earnings	851	659	1,512	4,282	2,013	3,621
Total Earned Net Worth	15,004	6,185	18,644	32,759	27,295	29,428
Total Net Worth	53,100	19,751	62,070	101,107	122,437	95,930
Total Liabilities and Net Worth	$196,330	$99,189	$307,483	$511,818	$415,072	$463,440

Exhibit 5-C.3
Banks for Cooperatives
Statement of Condition
September 30, 1985
($000 Omitted)

	St. Paul	Omaha	Wichita	Texas	Sacramento	Spokane	Central
Loans to Cooperatives: Seasonal Loans	$ 299,911	$128,714	$152,966	$ 31,208	$589,382	$219,812	$1,411,340
Term	1,116,787	313,113	322,612	123,162	182,997	202,422	1,813,601
Commodity	17,686	3,000	54,700	3,100	12,281	0	9.978
Acceptances	32,000	0	4,433	2,000	0	0	71,323
Subtotal	1,466,384	444,827	534,711	159,470	784,659	422,234	3,306,243
Less: Participations	485,104	29,826	108,414	20,703	311,400	105,160	59,210
Less: Acceptances Discounted to Other FC Banks	0	0	0	0	0	0	0
Less: Unapplied Loan Payments	0	1,156	1,644	0	211	0	0
Less: Unearned Income (Acceptances)	146	23	114	0	0	0	794
Total Loans to Cooperative Associations	981,134	413,822	424,539	138,767	473,049	317,074	3,246,239
Nonaccrual Loans	4,261	5,777	1,580	5,393	32,457	1,960	52,885
Sales Contracts, Notes, Etc.	10,035	159	174	382	34,973	369	28,750
Accrued Interest Receivable on Loans	27,891	12,669	10,903	3,948	7,553	7,286	69,108
Gross Loan Items	1,023,321	432,428	437,196	148,490	548,033	326,689	3,396,982
Less: Allowance for Losses	18,708	5,538	4,724	2,266	15,589	5,004	39,007
Net Loan Items	1,004,613	426,890	432,472	146,224	532,443	321,685	3,357,975
Cash	5,070	1,122	2,415	1,013	1,045	397	376
Investments: U.S. Government Securities (Par)	0	5,000	0	0	0	800	0
Securities Government Supervised Institutions (Par)	0	11,000	0	0	450	13,500	4
Other Securities and Federal Funds	130,147	69,938	51,701	81,088	4,174	33,956	897,375
Unamortized Premium or Discount (Net)	-1,157	-12	-172	-184	0	-632	-1,516
Total Investment in Securities	128,989	85,925	51,528	80,903	4,624	47,623	895,862
Investments in Central Bank for Cooperatives	69,140	5,350	21,455	5,058	21,194	10,706	0
Investments in Other Banks for Cooperatives	2,683	0	7,861	316	0	0	0
Investments in DBC Bankers Acceptances (Net)	0	0	0	0	0	0	0
Notes Receivable Farm Credit Banks and Other	28,295	10,856	1,999	586	34,729	3,249	13,559
Accounts Receivable	5,243	926	2,902	383	4,549	978	670
Accrued Interest Receivable - Other Farm Credit Banks	790	104	39	19	56	9	243
Accrued Interest Receviable - Investments	1,227	1,632	45	352	34	80	2,042
Acquired Property	647	542	734	2,359	683	372	1,254
Less: Accumulated Depreciation	0	0	0	0	0	87	0
Less: Allowance for Losses	0	166	0	0	0	97	0
Net Acquired Property	647	376	734	2,359	683	188	1,254
Land, Buildings, and Equipment	6,046	2,612	2,021	10,006	4,826	8,443	2,015
Less: Accumulated Depreciation	1,418	1,003	531	432	1,046	851	1,006
Net Land, Buildings, and Equipment	4,627	1,609	1,490	9,573	3,779	7,592	1,009
Customers Liability on Acceptances Outstanding	0	0	0	0	0	0	0
Prepaid Expenses and other Assets	6,850	1,445	1,424	812	640	1,414	6,722
Total Assets	$1,258,175	$536,234	$524,364	$247,597	$603,776	$393,922	$4,279,714

Exhibit 5-C.4
Banks for Cooperatives
Statement of Condition
September 30, 1985
($000 Omitted)

	St. Paul	Omaha	Wichita	Texas	Sacramento	Spokane	Central
Notes Payable: Other Farm Credit Banks	$ 8,913	$ 0	$ 11,500	$ 0	$ 0	0	$ 287,379
Consolidated Systemwide Notes	175,394	976	111,627	65,564	277,110	149,602	2,369,852
Commercial Banks and Other	8,710	0	0	1,234	4,204	2,448	1,798
Securities Sold Under Agreement to Repurchase	0	14,868	0	0	0	0	0
Total Notes Payable	193,016	15,844	123,127	66,798	281,314	152,050	2,659,029
Accounts Payable	4,027	6,581	3,999	27	1,485	409	7,951
Accrued Interest Payable	27,047	13,517	5,918	3,435	4,550	6,447	34,738
Unmatured Consolidated and Systemwide Bonds	788,610	412,250	215,114	97,001	190,000	177,000	1,253,605
Less: Consolidated Bonds Owned	0	25,000	0	0	0	0	0
Net Consolidated and System Bonds Outstanding	788,610	387,250	215,114	97,001	190,000	177,000	1,253,605
Unmatured Farm Credit Investment Bonds Outstanding	7,175	11,605	25,398	32,521	0	1,630	0
Matured Farm Credit Investment Bonds Outstanding	0	0	0	0	0	0	0
Capital Stock and Equities Called For Retirement	0	0	0	5	0	1,769	0
Bankers Liability on Acceptances Outstanding	0	0	0	0	0	0	0
Other Liabilities	2,347	1,349	841	309	597	171	2,494
Total Liabilities	1,022,222	436,145	374,396	200,096	477,946	339,476	3,957,817
Capital Stock: Class B - All	0	0	0	0	475	0	0
Class C - District Banks	1,117	6,361	230	309	0	554	229,515
Class C - Cooperative Associations	158,621	69,032	101,861	26,492	85,056	38,440	0
Class D - All	1,127	0	0	0	0	0	0
Other - Cooperative Associations	0	0	1,530	0	0	0	0
Class C - Subscribed - Cooperative Associations	11,677	2,768	4,230	381	5,510	1,342	0
Class C - Subscribed - District Banks	37	189	0	11	0	0	0
Total Capital Stock	172,578	78,350	107,851	27,274	91,040	40,336	229,515
Earned Net Worth: Surplus Reserved	6,638	2,423	6,336	5,038	6,658	5,014	29,676
Surplus Allocated to Cooperative Associations	50,743	13,891	23,564	4,415	21,235	7,859	0
Surplus Allocated to District Banks	322	746	48	71	0	117	32,210
Surplus Unallocated	5,670	3,717	4,511	9,852	1,359	1,375	8,681
Undistributed Earnings	0	962	7,637	853	5,538	-254	21,815
Total Earned Net Worth	63,374	21,739	42,116	20,228	34,789	14,109	92,382
Total Net Worth	235,953	100,089	149,967	47,502	125,830	54,445	321,897
Total Liabilities and Net Worth	$1,258,175	$536,234	$524,364	$247,597	$603,776	$393,922	$4,279,714

Exhibit 5-D.1
Banks for Cooperatives
Statement of Income
Three Months Ending September 30, 1985
($000 Omitted)

	Springfield	Baltimore	Columbia	Louisville	Jackson	St. Louis
Loan Interest Income: Cooperative Associations	$3,809	$1,539	$6,385	$11,842	$7,776	$9,960
Sales Contracts	1	68	416	0	0	0
Notes Receivable Other Farm Credit Banks	43	65	6	11	227	0
Other Interest Income	0	0	0	0	357	65
Total Interest Income from Loans	3,854	1,673	6,807	11,853	8,360	10,025
Income from Investments (Net)	317	409	589	1,518	751	1,236
Compensation Income - Participations Sold	2	0	0	0	0	0
Appraisal and Loan Service Fees	0	0	0	0	0	3
Financially Relate Services	0	0	0	0	0	12
Customers Draft Accepted Fees	0	0	0	0	0	0
Letters of Credit Issued Fees	46	0	36	1	126	0
Income from Distribution of Earnings of Central BC	2,215	366	0	0	0	258
Income from Dist. of Earnings of Other District Banks	0	0	0	0	0	0
Gross Earnings	6,433	2,448	7,433	13,372	9,237	11,534
Notes and Bonds Expense: Cost of Bonds	2,338	1,389	4,846	9,429	5,838	8,490
Interest on Notes Payable	780	374	1,604	1,002	1,286	351
Total Cost of Borrowed Funds	3,119	1,763	6,449	10,431	7,124	8,841
Compensation Expense - Participations Purchased	0	2	0	0	0	0
Operating Expense	480	334	717	1,375	1,140	941
Total Expenses	3,599	2,098	7,166	11,805	8,263	9,782
Net Gain (Loss) from Operations	2,834	350	266	1,567	974	1,752
Other Add/Deduct: Gain (Loss) - Sale of Investment	0	0	0	-126	0	0
Income (Expense) Acquired Property	0	0	0	0	0	0
Gain (Loss) - Disposition of Acquired Property	0	0	0	0	0	0
Provision for Losses - Acquired Property	0	0	0	0	0	0
Income (Expense) Office Building or Premises	0	0	0	0	0	0
Income (Expense) Land/Buildings (Investment)	0	0	0	0	-7	0
Other Gains (Losses)	-403	-185	-39	-1,180	-925	-583
Other Income (Expense)	21	0	15	3	0	0
Total Other Additions and Deductions	-381	-185	-24	-1,304	-933	-583
Net Gain (Loss) Before Provision for Losses	2,452	163	242	262	39	1,168
Provision for Losses	0	-249	-239	-149	-249	-149
Net Earnings before Income Taxes	2,452	-86	2	112	-210	1,018
Less: Federal and Other Income Taxes	0	-3	75	0	0	91
Net Earnings	$2,452	$ -82	$ -72	$ 112	$ -210	$ 927

Exhibit 5-D.2
Banks for Cooperatives
Statement of Income
Three Months Ending September 30, 1985
($000 Omitted)

	St. Paul	Omaha	Wichita	Texas	Sacramento	Spokane	Central
Loan Interest Income: Cooperative Associations	$27,736	$12,693	$10,811	$4,147	$12,946	$8,440	$78,846
Sales Contracts	189	5	0	13	841	10	737
Notes Receivable Other Farm Credit Banks	404	107	71	1	81	39	489
Other Interest Income	787	3	55	-12	0	0	7
Total Interest Income from Loans	29,116	12,808	10,937	4,147	13,868	8,489	80,079
Income from Investments (Net)	2,457	1,958	799	1,650	78	898	19,273
Compensation Income - Participations Sold	0	0	0	0	0	0	0
Appraisal and Loan Service Fees	0	0	0	0	0	0	0
Financially Related Services	0	0	12	0	0	0	0
Customers Draft Accepted Fees	0	0	0	0	0	0	0
Letters of Credit Issued Fees	64	12	8	19	1	1	659
Income from Distribution of Earnings of Central BC	2,364	401	337	213	800	255	0
Income from Dist. of Earnings of Other District Banks	0	0	0	0	0	0	0
Gross Earnings	34,001	15,179	12,093	6,029	14,748	9,644	100,011
Notes and Bonds Expense: Cost of Bonds	21,962	11,444	6,331	3,368	5,294	5,782	36,687
Interest on Notes Payable	3,634	412	1,725	1,226	5,950	2,154	52,217
Total Cost of Borrowed Funds	25,595	11,857	8,056	4,594	11,244	7,936	88,903
Compensation Expense - Participations Purchased	0	0	0	0	0	0	0
Operating Expense	2,051	1,411	1,811	867	875	885	3,531
Total Expenses	27,646	13,268	9,867	5,461	12,119	8,821	92,434
Net Gain (Loss) from Operations	6,355	1,911	2,227	568	2,628	823	7,577
Other Add/Deduct: Gain (Loss) - Sale of Investment	0	0	0	0	0	0	0
Income (Expense) Acquired Property	-14	-1	0	-4	0	32	0
Gain (Loss) - Disposition of Acquired Property	0	0	0	0	0	0	0
Provision for Losses - Acquired Property	0	0	0	0	0	0	0
Income (Expense) Office Building or Premises	0	0	0	0	0	-27	130
Income (Expense) Land/Buildings (Investment)	0	2	0	0	0	3	0
Other Gains (Losses)	-1,797	-1,792	-665	-263	-1,154	-472	-275
Other Income (Expense)	11	-4	3	5	1	0	7
Total Other Additions and Deductions	-1,800	-1,797	-663	-263	-1,154	-464	-138
Net Gain (Loss) Before Provision for Losses	4,553	113	1,563	303	1,473	358	7,438
Provision for Losses	-299	-2,154	-194	-224	-1,149	-176	0
Net Earnings before Income TAXES	4,253	-2,041	1,368	78	323	182	7,438
Less: Federal and Other Income Taxes	189	74	0	0	0	25	99
Net Earnings	$ 4,064	$-2,115	$ 1,369	$ 78	$ 323	$ 157	$ 7,339

EXHIBIT 5-E.1

BANKS FOR COOPERATIVES
NONPERFORMING LOANS, CHARGEOFFS, AND
FINANCIAL RATIOS
SEPTEMBER 30, 1985

	SPRINGFIELD	BALTIMORE	COLUMBIA	LOUISVILLE	JACKSON	ST. LOUIS
Nonperforming Loans ($ millions)	0.6	5.3	60.5	2.6	2.9	34.7
Formally Restructured	0	0.1	0	0	0	0
Other Restructured & Reduced Rate	0	0	0	0	0	0
Other High Risk	a	3.6	42.5	1.4	0.5	32.5
Nonaccrual	0.6	1.6	18.0	1.2	2.4	2.2
Net Chargeoffs ($ millions)	0	0	2.0	0	0.1	(0.5)
Selected Ratios						
Return on Assets (%)	5.05	(0.33)	(0.09)	0.8	(0.20)	0.77
Return on Equity (%)	18.63	(1.60)	(0.47)	0.42	(0.69)	3.84
Net Interest Margin (%)	2.51	1.40	1.27	2.27	2.21	2.13
Capital-to-Assets	0.27	0.20	0.20	0.20	0.29	0.21
Debt-to-Capital	2.70	4.02	3.95	4.06	2.39	3.83

a Indicates less than $50,000
* Indicates net loan chargeoff less than $50,000

Exhibit 6-A.1

TRENDS IN CONDITION AND INCOME

	Federal Land Banks Summary of Condition				
	12-31-84	03-31-85	06-30-85	09-30-85	12-31-85
Loans - total principal	52,261.5	52,103.9	51,056.4	49,254.9	
Performing	48,276.7	46,769.4	45,614.3	43,156.5	
Restructured	6.2	8.1	8.3	10.3	
Other restructured & reduced rate	9.0	42.8	9.8	17.1	
Other high risk	2,853.8	3,980.5	3,570.1	2,773.7	
Nonaccrual	1,115.8	1,303.1	1,853.9	3,297.3	
Less: Allowance for losses	547.1	529.2	512.7	915.6	
Net loans	51,714.4	51,574.7	50,543.7	48,339.3	
Cash & investments in securities	1,260.3	1,316.9	1,388.3	2,041.4	
Net acquired property	313.8	400.2	568.9	674.7	
Other assets net of adjustments	2,159.8	1,327.9	1,709.8	2,224.6	
Total assets	55,448.3	54,619.7	54,210.7	53,280.0	
Total liabilities	49,411.1	48,525.7	48,182.2	47,920.3	
Capital stock & participation certificates	2,854.1	2,841.1	2,772.8	2,671.1	
Earned net worth	3,183.0	3,252.9	3,255.7	2,688.5	
Total net worth	6,037.1	6,094.0	6,028.5	5,359.6	

Components may not add to exact totals due to rounding.

Exhibit 6-A.2
Federal Land Banks
Trends in Income and Expenses

	9 months ending					
	09-30-84	09 -30-85	03-31-85	06-30-85	09-30-85	12-31-85
Total Interest Income	4,671.2	4,509.5	1,546.7	1,526.8	1,435.9	—
Less: Total Interest Expense	4,323.0	4,096.4	1,392.9	1,364.4	1,339.1	—
Net Interest Income	348.2	413.1	153.8	162.4	96.8	—
Less: Provision for Loan Losses	20.1	612.0	22.8	79.9	509.8	—
Net Interest Income after Provision	328.1	(198.9)	131.0	82.5	(412.5)	—
Plus: Other Income	50.7	13.5	8.2	4.5	3.2	—
Less: Other Expenses	189.0	301.9	69.3	84.2	150.8	—
Net Income	189.8	(487.3)	69.9	2.8	(560.1)	—

Exhibit 6-A.3
Federal Land Banks
Trends in Selected Financial Measures

	12-31-84	03-31-85	06-30-85	09-30-85	12-31-85
Return on assets (%)	0.34	0.51	0.02	(4.17)	—
Return on equity (%)	3.08	4.61	0.19	(39.35)	—
Net interest margin (%)	0.89	1.18	1.26	0.75	—
Net chargeoffs on loans ($ millions)	90.4	40.7	98.3	140.3	—
Capital-to-assets ratio	0.11	0.11	0.11	0.10	—
Debt-to-capital ratio	8.18	7.96	7.99	8.94	—

Source: Reports of financial condition and performance.
Components may not sum to totals due to rounding.

TRENDS IN CONDITION AND INCOME

Exhibit 6-B.1
Federal Intermediate Credit Banks
Summary of Condition

	12-31-84	03-31-85	06-30-85	09-30-85	12-31-85
Loans - total principal	17,274.3	16,012.0	16,202.5	15,733.2	
Performing	14,827.3	13,215.7	12,373.4	11,749.6	
Restructured	31.1	35.1	38.5	612.5	
Other restructured & reduced rate	—	260.5	299.5	0	
Other high risk	2,135.0	2,253.9	3,362.3	3,266.4	
Nonaccrual	280.9	246.8	128.8	104.7	
Less: Allowance for losses	29.3	32.1	34.2	51.0	
Net loans	17,245.0	15,979.9	16,168.3	15,682.2	
Cash & investments in securities	1,328.1	1,254.4	1,296.9	1,733.0	
Net acquired property	3.5	3.0	4.6	13.2	
Other assets net of adjustments	784.6	687.1	691.3	603.9	
Total assets	19,361.2	17,924.4	18,161.1	18,032.3	
Total liabilities	17,362.6	15,894.3	16,144.7	16,056.6	
Capital stock & participation certificates	1,425.4	1,424.4	1,416.5	1,412.6	
Earned net worth	573.2	605.6	599.9	563.0	
Total net worth	1,998.6	2,030.0	2,016.4	1,975.7	

Components may not add to exact totals due to rounding.

Exhibit 6-B.2

Federal Intermediate Credit Banks

Trends in of Income and Expenses

	9 months ending 09-30-84	9 months ending 09-30-85	03-31-85	06-30-85	09-30-85	12-31-85
Total Interest Income	1,603.9	1,382.1	481.0	448.7	452.4	—
Less: Total Interest Expense	1,410.5	1,164.7	420.7	379.9	364.1	—
Net Interest Income	193.4	217.4	60.3	68.8	88.3	—
Less: Provision for Loan Losses	2.0	51.4	4.1	22.9	24.4	—
Net Interest Income after Provision	191.4	166.0	56.2	45.9	63.9	—
Plus: Other Income	0.5	76.6	0.6	(0.1)	76.4	
Less: Other Expenses	67.9	242.0	24.0	38.6	179.7	—
Net Income	124.0	0.6	32.8	7.2	(39.4)	—

Exhibit 6-B.3

Federal Intermediate Credit Banks

Trends in Selected Financial Measures

	12-31-84	03-31-85	06-30-85	09-30-85	12-31-85
Return on assets (%)	0.62	0.70	0.02	(0.87)	—
Return on equity (%)	6.17	6.52	0.19	(7.89)	—
Net interest margin (%)	1.38	1.37	1.26	2.03	—
Net chargeoffs on loans ($ millions)	21.9	1.2	98.3	1.3	—
Capital-to-assets ratio	0.10	0.11	0.11	0.11	—
Debt-to-capital ratio	8.69	7.83	7.99	8.13	—

TRENDS IN CONDITION AND INCOME

Exhibit 6-C.1
Banks for Cooperatives
Summary of Condition

	12-31-84	03-31-85	06-30-85	09-30-85	12-31-85
Loans - total principal	9,014.0	9,168.1	8,343.2	7,751.1	
Performing	8,476.2	8,553.1	7,793.2	7,199.0	
Restructured	44.8	36.0	39.6	14.4	
Other restructured & reduced rate	0.3	0.2	0.0	47.6	
Other high risk	478.1	564.9	480.2	359.6	
Nonaccrual	14.6	13.9	30.2	130.5	
Less: Allowance for losses	121.2	124.6	128.2	122.4	
Net loans	8,892.8	9,043.5	8,215.0	7,628.7	
Cash & investments in securities	843.5	908.1	1,516.0	1,519.9	
Net acquired property	3.9	3.9	6.3	6.3	
Other assets net of adjustments	334.3	309.0	332.7	280.4	
Total assets	10,074.5	10,264.5	10,069.5	9,435.3	
Total liabilities	8,867.9	9,061.0	8,850.2	8,227.8	
Capital stock & participation certificates	861.3	835.4	843.5	832.4	
Earned net worth	345.3	368.1	375.9	375.1	
Total net worth	1,206.6	1,203.5	1,219.4	1,207.5	

Components may not add to exact totals due to rounding.

Exhibit 6-C.2
Banks for Cooperatives
Trends in of Income and Expenses

	9 months ending					
	09-30-84	09-30-85	03-31-85	06-30-85	09-30-85	12-31-85
Total Interest Income	892.8	759.2	266.7	260.1	232.4	—
Less: Total Interest Expense	740.9	628.4	220.3	213.7	194.4	—
Net Interest Income	151.9	130.8	46.4	46.4	38.0	—
Less: Provision for Loan Losses	11.3	12.5	3.4	3.8	5.2	—
Net Interest Income after Provision	140.6	118.3	43.0	42.6	32.8	—
Plus: Other Income	3.4	2.9	0.9	1.0	1.0	—
Less: Other Expenses	44.8	60.3	16.0	17.7	26.5	—
Net Income	99.0	60.9	27.9	25.9	7.1	—

Exhibit 6-C.3
Banks for Cooperatives
Trends in Selected Financial Measures

	12-31-84	03-31-85	06-30-85	09-30-85	12-31-85
Return on assets (%)	1.29	1.10	1.02	0.29	—
Return on equity (%)	11.09	9.25	8.55	2.35	—
Net interest margin (%)	1.99	1.85	1.84	1.58	—
Net chargeoffs on loans ($ millions)	10.1	*	0.2	11.1	—
Capital-to-assets ratio	0.12	0.12	0.12	0.13	—
Debt-to-capital ratio	7.35	7.53	7.26	6.81	—

Source: Reports of financial condition and performance.
Components may not sum to totals due to rounding.

* Indicates less than $50,000.

Appendix B

Percentage distribution of commercial farm operators and their assets and debt, by financial position

January 1985

Financial position	Operators	Assets	Total debt	Debt owed to--		
				Banks	Farm Credit System	Farmers Home Adm.
Good.........	70	65	51	47	53	39
Fair.........	13	18	16	15	15	18
Stressed.....	7	7	10	13	12	12
Vulnerable...	10	10	23	25	20	31
Total.....	100	100	100	100	100	100

Data for 634,000 "commercial" farms with sales of $40,000 or more in 1984, from the 1984 Farm Costs and Returns Survey, ERS, USDA. Dr. Emanuel Melichar, Farm Economist, Federal Reserve, October 23, 1985, testimony before the subcommittee on economic stailization of the House Banking, Financial, and Urban Affairs Committee, page 11.

Statement by
Ray Moss Tucker, Chairman
The Farm Credit Council

Mr. Chairman:

I am Ray Moss Tucker, a farmer from Finchville, Kentucky. I am Chairman of the Board of The Farm Credit Council. I serve also as Chairman of the Council's Legislative Committee, and it is in that capacity that I appear before you today.

The Council was formed in 1982 and is the federated national association of borrower-owned farm lending institutions across the country, including all 37 of the nation's Farm Credit Banks and over 90 percent of all Production Credit and Federal Land Bank Associations nationwide.

With me at the table are James Roll, Senior Vice President of the Federal Farm Credit Banks Funding Corporation of New York; and Gene Swackhamer, President of the Farm Credit Banks of Baltimore. Following my statement, Mr. Roll will testify on the financial condition of the Farm Credit System and the problems which we face in marketing our securities. Mr. Swackhamer will conclude by presenting our proposal for Government financial assistance.

Mr. Chairman, the banks and associations that make up the Farm Credit System are directed, by law, to serve the credit and financial service needs of U.S. agriculture. They are farmer-owned and farmer-directed organizations, dedicated totally to the moving of capital on a dependable basis from the nation's money markets to U.S. farmers, ranchers and their cooperatives. They exist for no other purpose.

The quality of our assets is fully dependent upon the financial health of agriculture and the rural economy.

At a meeting in mid-September the Boards of Directors of the 37 Farm Credit Banks received a report on the financial condition of the System and the market conditions for Farm Credit System-wide securities. Using USDA forecasts as well as our own, directors were briefed on the anticipated further deterioration in the nation's farm economy over the next two years. Their unanimous conclusion was that **absent government financial assistance, the System cannot survive the radical transition underway in agriculture.**

At that mid-September meeting, the Legislative Committee of the Farm Credit Council was authorized and directed to immediately develop and pursue on behalf of the Farm Credit System, a request for government financial assistance which would restore farmer and investor confidence in the System and permit it to carry out its mandate to provide a dependable credit source for U.S. Agriculture. I've attached the principles for seeking assistance which were adopted by the directors at the September meeting.

Mr. Chairman, I've been a long-time farmer-borrower from a PCA, president of a large borrowing cooperative and, for six years, a member of the Louisville District Farm Credit Board. I am proud of our farmer-owned System and of Congress for having the foresight to establish it some 70 years ago.

All of the System institutions--the Federal Land Banks, the Federal Intermediate Credit Banks (FICBs), the Production Credit Associations (PCAs), the Federal Land Bank Associations (FLBAs) and the Banks for Cooperatives--have played a critical role in the development of U.S. agriculture. We believe that we have lived up to the intent of Congress that the Farm Credit System provide a dependable source of credit to agriculture.

Mr. Chairman, we are most proud of the fact that in 1968, the Farm Credit System became entirely farmer-owned when Federal capital was repaid!

Because we have been farmer-owned and directed for these past 17 years, our request for Federal assistance today is one of the most difficult decisions which we have ever made as an organization, but frankly speaking, we have no other choice.

We have $13 billion of problem loans with exposure to loan losses of $3 billion or more and another potential $3 billion of operating losses in 1986-87! It's a problem which has been developing for several years and which we have been trying to solve without government assistance for well over two years now.

Our problems are driven, not by the actions of a single borrower or association or any combination thereof, but by an industry being torn apart by large supplies, declining exports, deflation and some of the highest real interest rates in history--all of which led to some of the steepest drops in land values ever in history.

Land values throughout the North Central and Midwest states have fallen by over 50 percent in the last five years, and the worst may not be over.

According to USDA data, over 215,000 farmers have debt-to-asset ratios above 70 percent and negative cash flow. They're in the most jeopardy of losing their farms in the next year to 18 months.

Some of our critics will argue that the System made decisions which brought on the very problems we are trying to come to grips with today. We are accused of making bad loans and encouraging farmers to expand when they shouldn't have. Hindsight is always 20-20. It points out the mistakes of Farm Credit banks and associations, commercial banks, farmers, farm journalists, agribusinesses, land grant university economists and even government policies which encouraged fence-row-to-fence-row planting.

There's no doubt that the System made some weak loans, just as all lenders did. However, most of those $13 billion in now-troubled loans were sound loans when they were made, both from the standpoint of collateral and repayment. And most of them were made to good farmers. Furthermore, we didn't and they didn't mismanage the whole of rural America.

Bad loans alone are not the cause of the serious, underlying problems in agriculture which we are all working to solve. No one could have forecasted the dramatic devaluation in the balance sheet of U.S. agriculture. And no financial institution with its assets fully in that industry could have been capitalized high enough to weather the shock moving through this industry.

In the Louisville district, for example, we currently have almost 3,000 loans totaling $537 million on which the payments aren't being made! And there's upwards of 11,000 additional loans amounting to $1.5 billion which may be in trouble next year!

What we propose today is a program of continued self-help among these farmer-owned organizations with a life-line or safety net to government. I emphasize this is **continued** self help. The financial stress among farmers and its impact upon these institutions are subjects we've been facing and managing for several years. Our goal has been to ensure that the Farm Credit System continued to be a reliable supplier of credit and services at the lowest reasonable cost to farmers, ranchers and their cooperatives.

I would like to highlight a number of the comprehensive self-help measures taken by the System to date.

First, at the district level, carefully planned loss-sharing agreements were entered into among PCAs. These agreements were to take effect only after an association had used its own loss reserves, current income and usually 10 percent of its surplus. But, we did not ask any association to impair its farmer-borrowers stock. Those loss sharing agreements have been triggered among PCAs in three-fourths of the districts over the past three years.

Second, on a case-by-case basis, district banks have provided financial assistance under agreements entered into between the assisted association and its supervising bank. This mechanism was to be used only if local resources and intra-district association loss-sharing could not maintain the viability of the local association. In the case of PCAs, help came in the form of an investment from the Federal Intermediate Credit Banks, either by the purchase of non-accrual assets--primarily nonaccrual loans and acquired property--or by the direct infusion of capital. All twelve district FICBs made some such investments in local PCAs, amounting to more than $181 million at June 30, 1985. Subsequent to June 30th, the Omaha FICB had invested about $120 million in its PCAs, $75 million of which was financed by their district bank.

Third, if the financial stress within a district were such that the viability of a district bank were in jeopardy, inter-district capital preservation agreements would be activated. The troubled banks were required to look first to their sister banks within their district for assistance, and then to all System banks recognizing the joint and several liability of the 37 banks on all System-wide obligations. We've had these agreements in place since the late 1970's.

To supplement capital preservation agreements among the districts, special inter-district assistance programs were developed and applied for the first time in ~~1985~~, to assist the Spokane and Omaha Federal Intermediate Credit Banks. To help those two banks alone, the other banks of the System committed a total of $476 million--$136 million for the Spokane FICB and $340 million for the Omaha FICB.

Fourth, to facilitate and to administer those assistance plans, the 37 Farm Credit Banks chartered and capitalized the Farm Credit System Capital Corporation -- headquartered in Wichita, Kansas -- specifically to acquire--on behalf of all 37 banks--the nonaccrual assets of troubled banks in Omaha and Spokane.

Fifth, to better protect the farmer-borrower's stock investment, to cut costs and achieve operating and organizational efficiencies, a number of districts have developed--and some have implemented--proposals to pool the capital of PCAs within the district through consolidations of associations into single, district-wide organizations, or through expanded district loss-sharing programs. To date, seven of the twelve districts' farmer boards of directors of PCAs have approved such proposals. In two districts, those proposals have already won the required stockholder approvals and are now being implemented. In three districts, FLBA boards of directors have voted to form a district-wide FLBA. One of those proposals has been presented for and has received stockholder approval. And, I think it's important to note, Mr. Chairman, that in every instance, these votes have been by very decisive margins, which we would be pleased to provide to the Committee.

Sixth, in recent years the districts made substantial progress in establishing single Farm Credit service centers in communities which have both a PCA and Federal Land Bank Association. These actions have already resulted in elimination of duplicate facilities, reduced overhead and improved coordination in the extension of credit to our farmer stockholders.

Seventh, we've consolidated the management of the district banks--the Banks for Cooperatives, the Federal Intermediate Credit Banks and the Federal Land Banks. Of ten districts which now have consolidated management for the three district banks, eight of those consolidations have occurred since 1982. Again, the result is more effective use of executive talent, reduced overhead and improved coordination in credit programs and services.

Eighth, we've cut staff. In 1985, we will have reduced System-wide employment by 10%--over 1,700 people--to an estimated 15,600 by the end of this year. Some district banks have suffered staff cut-backs of 30 percent. This represents a cost savings of approximately $60 million per year.

Ninth, apart from these issues, the System banks and associations have recognized their losses. Between 1982 and 1984, chargeoffs totalled $1 billion. This year alone, we expect chargeoffs among System banks and associations to exceed the amount of the previous three years combined.

These steps have helped us absorb 3rd Quarter losses by the 37 banks of $522 million, the first aggregate loss reported by the 37 banks since the 1930s!

Mr. Chairman, the actions just described have not been universally popular, but they have been undertaken in good faith and with critical input from our farmer-stockholders. We're in a predicament as farmers and directors of the Farm Credit System. On one hand, we see firsthand, the gut-wrenching problems which result from the lack of profitability in agriculture. On the other hand, as directors, we set policies to maintain the viability of our associations, even though this may result in higher interest rates to farmers.

Perhaps it is because we are farmers and have believed that the ag economy would turn around that we have stayed with farmers as long as we have. Some would say we've stayed too long, or else we wouldn't be projecting $6 billion in non-accrual loans by the end of this year and $13 billion over the next two years. Many of these loans would have been liquidated over the past six years had we pursued more aggressive credit administration practices.

We have worked hard to carry out a responsible policy of forebearance; but there are still at least three problems with a policy of forebearance: (1) you can never have done enough of it; (2) it can only be rationalized if there's a reasonable expectation that financial health will be restored to the borrower or, in this case, the industry; and (3) it costs money--in the form of carrying cost on non-accrual loans--and this cost is borne by the remaining borrowers through higher interest charges.

Frankly, these costs have come home to roost. The resulting higher rates are driving farmers who can't refinance toward bankruptcy at an accelerating rate. These same higher rates are driving farmers who can refinance to other lenders. Still others flee out of fear that their stock investment in System institutions will soon be lost. The result is a downward spiral of confidence and capital base for the System as a whole. **During the first three quarters of 1985, the loan volume of the Farm Credit banks fell by more than $6 billion!**

We know the importance of helping farmers get through the tough times. After all, many of these same farmers helped build the Farm Credit System. But we also recognize that realistically some farmers still aren't going to survive even with maximum forbearance.

Mr. Chairman, the Farm Credit System has a solid record of assisting agriculture and repaying the government capital it was provided during its early years. The Government's initial investment was a partnership with America's farmers. It made good business sense and good policy. Now, seventeen years after we repaid that initial investment, we are once again asking you to help us ensure that the Farm Credit System continues to be able to live up to its Congressional mandate. We have tried and we will continue to try to solve our financial problems with our own resources, but these resources simply are not going to be enough! We need your help now in this session of Congress.

Thank you.

Statement by

James A. Roll, Senior Vice President

Federal Farm Credit Banks Funding Corporation

Mr. Chairman:

I am James Roll, Senior Vice President of the Federal Farm Credit Banks Funding Corporation, located in New York City. Unlike many financial institutions which generate loanable funds primarily through deposits, the Farm Credit System funds itself almost entirely through the issuance of securities in the capital markets. Currently, securities outstanding total nearly $70 billion.

Our role at the Funding Corporation is to direct the marketing of securities of the 37 Farm Credit Banks. We work with an independent selling group of approximately 150 securities firms and bank dealers who offer Farm Credit securities on a world-wide basis. Our investors include commercial banks, savings and loan associations, individuals, insurance companies, states and municipalities, pension and money market funds, foreign banks and governments and others.

Today, I will discuss the financial condition of the Farm Credit System, how the financial community has reacted to the current agricultural situation and its impact on the System.

Like other financial institutions, the Farm Credit System is subject to a wide variety of influences, both real and perceived, which affect our ability to successfully market our securities. This, in turn, affects both the interest rates which we charge to farmers and our financial statements. With a depressed agricultural economy and a fragile market for our securities, these influences have a more pronounced impact.

First, it's important to understand that although we clearly state that Farm Credit System securities are not an obligation of, nor guaranteed by the U.S. government, the market for System securities is nevertheless supported by a firmly held belief that because we are a government-sponsored financial institution, our securities are backed by the government of the United States. This is why there continues to be a market for our bonds today, despite our growing financial problems.

As Mr. Tucker said a few minutes ago, the Farm Credit System has identified potential nonearning assets of about $13 billion and a potential exposure to loan losses of $3 billion or more by December 31, 1987.

Mr. Tucker also spoke to the upward pressure on interest rates charged to farmers and cooperatives that results from the rapidly increasing cost of carrying these nonearning loans and acquired properties. As the financial markets become more uneasy with our financial problems, our increased costs for funds will result in interest rates to farmers that are even higher.

Heightened investor concern could mean that we become unable to market securities at all, and thus would not be able to repay our existing securities when they mature. As our interest rates rise, we lose our best borrowers. If we lose access to the market, we would soon default on our obligations. This is what the Farm Credit System faces absent government financial assistance. With that brief preface, I'd like to discuss what has already happened in the markets.

The financial community did not begin to focus on the problems in the agricultural economy until late 1984 or early 1985. Concern about agricultural conditions was heightened last spring with major articles focusing on agriculture's problems.

At the same time, the System's regular quarterly reports and periodic press releases on the financial condition of the Farm Credit Banks increasingly pointed out the adverse industry trends that were affecting System borrowers. While investors showed some concern about the problems of individual Farm Credit districts, overall, they continued to believe, as we did at the time, that the total System remained financially sound.

By early summer, this view began to change. Depressed commodity prices and slumping land prices began to be reflected in System financial statements. In mid-July, concern was heightened by reports that the System would experience significant loan losses. Our funding costs increased about 1/4 of 1 percent (25 basis points) in late July.

During August, the System released results of second quarter operations, projecting that the 37 Farm Credit Banks would incur an operating loss for the 3rd quarter of 1985, and--based upon what was known at that time--might incur an operating loss for the year.

During the first week of September, the market received the news that plans were being made to seek Federal assistance for the Farm Credit System. While this news was taken adversely, questions of an even more serious nature were raised concerning the number and amount of loans which might be uncollectable and how high our losses might run.

Wall Street reacted quickly, and as a result, the cost of new sales of Farm Credit securities increased another 1/2 to 3/4 of 1 percent above the U.S. Treasury rate. Toward the end of September, spreads over Treasury rates stabilized in the 3/4 - 1 percent range.

But this stability didn't last long. During the second week of October, the market was shaken again. The System's cost of funds increased an additional 1/8 - 1/4 percent, but a more important result was that the System can no longer sell issues of the size and maturities that fit its funding needs. Spreads are now between 1 and 1 1/4 percent over Treasury rates.

These so-called "shocks" to the market have a real impact. To give you a quick example, each year we market about $100 billion in securities. If our costs are 1 percent higher, the added cost on that $100 billion is $300 million in the first year alone, and that cost is ultimately paid by farmers!

While our cost of funds is important, the impact on the market for Farm Credit securities has gone far beyond the cost consequences alone. We have lost many of our traditional investors in Farm Credit securities who purchased them as a direct substitute for U.S. Treasury securities. System issues were quality investments. Now, because of the questions about our future, these investors have either sold their holdings or are holding them to maturity and not reinvesting.

Who are these traditional buyers? They include commercial banks, state and local governments, mutual funds and other institutional investors, who because of their fiduciary responsibilities, must be able to show that they have invested prudently. Because of the problems which we have and are trying to solve and the questions which others are raising about the Farm Credit System, it is very difficult for these investors to justify why they should continue to purchase System securities.

Consequently, the Farm Credit System has attracted a new type of investor, one who is willing to accept risk for a price. This investor believes that our securities represent an opportunity to earn a high return because they ultimately believe the Federal government will not let the Farm Credit System default.

If, however, the day should come that serious questions are raised about the commitment of the Federal government to the Farm Credit System, this new investor will also abandon System securities and the source of funds for farmer loans could dry up, **regardless of price!**

Last week, the System issued its Third Quarter Financial Report. In it, losses for the combined 37 Banks were reported for the first time since the 1930s. These losses totaled $522 million for the quarter and $426 million for the nine-month period ended September 30th. These losses were a direct result of a substantial provision for loan losses and the cost of the financial assistance package for the Omaha Federal Intermediate Credit Bank.

In view of depressed net farm income and declining farm land values, particularly in the Midwest, earlier this year we undertook a special nationwide credit review of the Federal land banks. This was initiated to help determine the likelihood of land bank borrowers repaying their notes (both principal and interest). This review showed that approximately $6 billion of the total of $48 billion in loans outstanding are currently undercollateralized by approximately $900 million. That is, the land serving as collateral is worth less than the mortgage on the land. As a result of this study and a general deterioration in our loan portfolio, the provision for loan losses was $675.9 million for the first nine months of 1985, compared to $77.4 million for the same period last year.

In addition, nonaccrual loans increased during the 3rd Quarter to $3.5 billion or almost 5 percent of loans outstanding, nearly double the amount reported on June 30, 1985. Nonaccrual loans are those for which accrual of interest has been suspended because of substantial doubt about the ultimate collection of principal and interest.

Based on the special credit review of Federal land banks and other economic studies, the Farm Credit Banks may be exposed to loan losses aggregating $3 billion or more during the 1985-87 period for which an allowance for loan losses of approximately $1.1 billion has been established as of September 30, 1985.

While I cannot predict the 4th quarter results for the System, I can tell you that we will make the necessary additions to the allowance for loan losses based on a further analysis of the loss exposure in the Banks' individual loan portfolios.

We stated in our quarterly report that the level of non-earning assets between now and the end of 1987 may be $10 billion or more. Obviously, not all nonaccrual loans will result in losses to the System. However, the cost of carrying this magnitude of nonearning assets and absorbing $3 billion or more in loan losses will likely result in multi-billion dollar net operating losses for the next several years!

I believe the market for Farm Credit securities would not tolerate losses of this magnitude without explicit evidence of government assistance.

We are striving to accurately reflect where we are and appropriately disclose information as soon as it is known by the banks. Furthermore, we are sensitive to the necessity for public confidence. This was the primary reason that the System retained the services of Price Waterhouse as auditors this year. They have been working in each Farm Credit bank toward the objective of presenting audited financial statements for the year ending December 31, 1985. I am confident that the Farm Credit banks will take whatever actions are necessary to earn an unqualified opinion from Price Waterhouse.

As I indicated earlier, each year we at the Funding Corporation issue upwards of $100 billion in bonds and discount notes on behalf of the Farm Credit System. While this total will be reduced somewhat this year as a result of loan payoffs, on a continuing basis the System needs to roll over outstanding debt of approximately $70 billion.

Continued deterioration in the financial condition of the Farm Credit System without explicit government assistance will increase the risk that the

System will not be able to meet its funding needs at any cost! This could ultimately result in an immediate financial crisis in terms of the System's ability to meet its maturing obligations. At the end of the third quarter, 37 bank liquidity--that is investments in liquid securities and cash--amounted to $5.3 billion. This is our cushion of liquid assets that would be used to retire maturing bonds and discount notes in the event the System were unable to go to the market. On average, the System must raise over $1.5 billion each week. In other words, absent government financial assistance or intervention, **the System could continue in business for about 18 days, if it were unable to market its obligations!**

Mr. Chairman, the Farm Credit System is at a major crossroads in its history. We continue to believe that we have provided sound lending to farmers, ranchers and their cooperatives within the limits established by the Congress. We can continue to fulfill that mission, but, in my professional opinion, we will not be able to do so without government assistance to ensure investor confidence and financial stability of the System.

(Attachments follow:)

Federal Farm Credit Banks
Funding Corporation

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New York, New York 10038
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News Release

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FOR IMMEDIATE RELEASE
October 23, 1985

FARM CREDIT BANKS ANNOUNCE THIRD QUARTER AND NINE MONTHS RESULTS

NEW YORK, Oct. 23, 1985 -- Peter J. Carney, President of the Federal Farm Credit Banks Funding Corporation, announced today the third quarter and nine months 1985 unaudited financial results for the combined 37 Farm Credit Banks:

Financial Highlights

Significant financial developments for the three months and nine months ended September 30, 1985 included:

- The combined Farm Credit Banks incurred net losses of \$522.5 million and \$426.3 million for the three months and nine months ended September 30, 1985, respectively, compared to net income of \$126.4 million and \$363.1 million recorded for the same periods in 1984.
- Total capital of the Farm Credit Banks at September 30, 1985 was \$8.5 billion, a decline of \$0.7 billion from the December 31, 1984 level.
- The provision for loan losses for the first nine months of 1985 was \$675.9 million; net loan charge-offs during the period amounted to \$317.9 million. The provision for loan losses and net charge-offs for the comparable period in 1984 were \$77.4 million and \$73.9 million, respectively. The allowance for loan losses at September 30, 1985 was \$1,089.0 million compared to \$745.1 million at June 30, 1985 and \$697.5 million at December 31, 1984. As

discussed below, the adequacy of the provision and related allowance for loan losses is currently being analyzed.

- Total risk funds for the 37 Farm Credit Banks, consisting of capital stock, surplus and the allowance for loan losses was $9.6 billion at September 30, 1985 compared to $10.0 billion at December 31, 1984.
- Net loans outstanding of the Farm Credit Banks were $70.7 billion at September 30, 1985, a decrease of $3.3 billion or 4.4 percent from the amount outstanding at June 30, 1985, and a decrease of $6.3 billion or 8.2 percent from December 31, 1984.
- Farm Credit securities outstanding decreased to $68.3 billion at September 30, 1985, compared to $70.0 billion outstanding three months earlier and $72.2 billion at December 31, 1984.

Proposals For Federal Government Assistance

The Boards of Directors of the 37 Farm Credit Banks agreed at a meeting in September 1985 to form a special Legislative Committee to seek Federal government assistance for the purpose of ensuring the Farm Credit System's continued viability. The Legislative Committee is developing proposals for System self-help and federal assistance ~~which~~ are currently being discussed with the United States Government with a view towards agreeing on solutions for the System's problems.

Financial Commentary

The net loss in the third quarter of 1985 is principally due to the effect of the increase in the the provision for loan losses, primarily in the Federal Land Banks (FLBs), and financial assistance provided to Production Credit Associations (PCAs).

The provision for loan losses of $469 million for the three months ended September 30, 1985 and $676 million for the first nine months of 1985 increased from $36 million and $77 million, respectively, during the same periods in the prior year. The combined Farm Credit Banks' allowance for loan losses to loans ratio increased from 1.0 percent at June 30, 1985 to 1.5 percent at September 30, 1985.

The provision for loan losses during the third quarter is directly related to the increase of $1.5 billion in nonaccrual loans which resulted from recognition of potential loan losses identified in a special credit review of the FLBs conducted by the Farm Credit Banks which was completed in September 1985, and the resulting reclassification of loans 90 days or more past due, on which interest was being accrued. Consistent with their accounting policies, the Farm Credit Banks are continuing to accrue interest on certain loans which were 90 days or more past due on the basis that they are well secured. The principal balance of such loans at September 30, 1985 was approximately $1.6 billion.

Loans in nonaccrual status increased to $3.5 billion or 4.9 percent of loans outstanding at September 30, 1985 compared to $2.0 billion or 2.7 percent of loans outstanding at June 30, 1985. Other property owned, acquired as a result of loan foreclosures, increased during the third quarter to $694 million at September 30, 1985 from $580 million at June 30, 1985. This increase is due to foreclosure activity and the relative difficulty of selling acquired properties in the saturated farm real estate markets of several districts. Other expenses for the nine months ended September 30, 1985 included a $100 million provision to recognize declines, subsequent to acquisition, in the value of other property owned. Such provision was not significant in the comparable prior period.

The special credit review of the FLBs indicated that approximately $6 billion of the FLBs' $48 billion of loans outstanding are currently undercollateralized to the extent that the loan amounts exceed the current estimated market value of the real estate collateral. As of the date of the review, the amount by which the outstanding balance of these loans exceeded the collateral values approximated $900 million. While many of the undercollateralized loans are now current as to the payment of principal and interest, some are expected to generate significant future losses.

The Farm Credit Banks have analyzed agricultural economic conditions and trends, and their potential impact on the Banks. This analysis was based upon economic studies conducted by the U.S. Department of Agriculture and the Farm Credit Administration. As a result of projected continuing deterioration in farm income and land values, the Farm Credit Banks may be exposed to loan losses aggregating $3.0 billion or more during the 1985-1987 period for which an allowance for loan losses of $1.089 billion has been established as of September 30, 1985. The Farm Credit Banks will make appropriate additions to the allowance for loan losses in the fourth quarter of 1985 based upon a detailed analysis of the loss exposure in the Banks' individual loan portfolios.

With respect to the increase in financial assistance to PCAs, the Boards of Directors of the System's Banks approved a financial assistance plan for the FICB of Omaha and its related PCAs in August 1985. Under the plan, the participating Farm Credit Banks made $75 million in loss sharing payments to the FICB of Omaha in September 1985. The FICB of Omaha contributed the $75 million received from the participating Banks and $50 million of its own funds to its most financially-troubled PCAs. Such amounts were charged to expense in the third quarter. If certain conditions are satisfied, the plan will also require the participating Banks to purchase, through the Farm Credit System Capital Corporation, approximately $240 million of high-risk assets of the Omaha District PCAs in late 1985 or early 1986.

Financial difficulties continue to be experienced by PCAs whose results, although not included in the combined Farm Credit Banks' financial statements, have a significant impact on the financial condition of the FICBs. The combined PCAs are expected to incur significant operating losses during 1985 following net losses of $116 million before distribution of FICB earnings in calendar year 1984. PCA combined loan losses for 1985 are projected to be approximately $500 million compared to the 1984 level of $285 million. Due to the severely weakened financial condition of PCAs in several districts, it is possible that additional financial assistance will be required to be provided by the respective FICBs during the fourth quarter. In addition, several Farm Credit districts are currently developing plans to merge the PCAs in a district into one or more larger PCAs to centralize management and to pool capital and other resources. Such mergers were approved by the PCA stockholders in the Spokane and Jackson districts during the 1985 third quarter. PCA stockholders in a number of other districts are expected to vote on such merger plans before the end of 1985.

The combined Banks have taken steps to improve their liquidity position, including establishment of a centrally-managed investment pool in which substantially all Banks are participating; investment securities and cash held by the banks and in the investment pool at September 30, 1985 increased to $5.3 billion, a 55 percent increase over the December 31, 1984 balance.

The Banks' capital position of $8.5 billion at September 30, 1985 consisted of $4.9 billion of capital stock and participation certificates and $3.6 billion of surplus. The decline of $651 million in total capital since June 30, 1985 is primarily due to the $522 million net loss recorded in the third quarter and net stock retirements resulting from reduced loan volume. As described in the **1984 Farm Credit Banks Report To Investors**, the capital structure of the Farm Credit Banks, as member-owned cooperatives, differs substantially from other commercial financial institutions because the issuance and retirement of capital stock and participation certificates are directly related to the lending activities of the Banks.

The Outlook

Agricultural economists, both within and outside the Farm Credit System, project that current negative trends in the U.S. agricultural economy will continue in the near term. Accordingly, significant increases in non-earning assets and loan losses are expected through the remainder of 1985 and the next two years. Based upon the economic projections referred to above, the Farm Credit System may have to deal with non-earning assets aggregating more than $10 billion over the next several years. Competitive pressures and the weakened financial condition of the System's borrowers may preclude the Banks from increasing interest rates to offset the factors having negative effects on the Banks' earnings.

In reflecting new information in the third quarter results, the Banks' early September estimate of the possible operating loss for calendar 1985 was exceeded during the first nine months. Additional losses are anticipated during the fourth quarter of 1985. However, the magnitude of such losses is dependent upon the resolution of the uncertainties discussed above with respect to the adequacy of the Banks' allowance for loan losses. System officials are presently discussing with representatives of the United States government proposals to address the System's problems through the utilization of the System's own resources and Federal assistance.

Copies of the unaudited financial statements of the combined 37 Farm Credit Banks for the three months and nine months ended September 30, 1985 are presently available from the Federal Farm Credit Banks Funding Corporation. Price Waterhouse has been engaged to audit the financial statements of the combined 37 Farm Credit Banks for the year ending December 31, 1985. Price Waterhouse has not audited the interim financial statements for the nine months ended September 30, 1985.

The Farm Credit System is a nationwide system consisting of borrower-owned financial institutions organized as cooperatives. The System is made up of 12 Federal Land Banks which make long-term loans through Federal Land Bank Associations; 12 Federal Intermediate Credit Banks which provide short-term and intermediate-term credit to Production Credit Associations and other qualified institutions serving agricultural producers; 13 Banks for Cooperatives which make loans to agricultural, aquatic and rural electric cooperatives, and provide financial services to exporting cooperatives.

* * * *

FOR FURTHER INFORMATION CONTACT:

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THE 37 FARM CREDIT BANKS

UNAUDITED COMBINED CONDENSED FINANCIAL STATEMENTS AND FINANCIAL COMMENTARY

SEPTEMBER 30, 1985

THE 37 FARM CREDIT BANKS
COMBINED CONDENSED STATEMENT OF CONDITION

(In Thousands of Dollars)

	September 30, 1985 (Unaudited)	December 31, 1984
Assets		
Loans, less allowance for loan losses of $1,089,025 and $668,898, respectively	$70,741,647	$77,088,964
Investment securities and cash	5,294,328	3,415,765
Total earning assets	76,035,975	80,504,729
Accrued interest receivable on loans	3,169,813	3,480,223
Premises, equipment and other assets less accumulated depreciation	630,323	525,448
Other property owned	694,138	321,138
Total assets	$80,530,249	$84,831,538
Liabilities and Capital		
Consolidated systemwide bonds	$56,055,114	$62,071,356
Consolidated bank and other bonds	4,770,723	5,231,095
Consolidated systemwide notes	7,461,434	4,890,051
Other liabilities	3,700,123	3,396,687
Total liabilities	71,987,394	75,589,189
Capital stock and participation certificates	4,916,260	5,140,829
Surplus	3,626,595	4,101,520
Total capital	8,542,855	9,242,349
Total liabilities and capital	$80,530,249	$84,831,538

THE 37 FARM CREDIT BANKS
COMBINED CONDENSED STATEMENT OF OPERATIONS

(In Thousands of Dollars)

	For the 3 Months Ended September 30,		For the 9 Months Ended September 30,	
	1985	1984	1985	1984
	(Unaudited)			
Interest income				
Interest and other charges on loans	$2,018,966	$2,329,570	$6,383,471	$6,754,733
Interest on investment securities	98,613	79,401	248,781	213,693
Total interest income	2,117,579	2,408,971	6,632,252	6,968,426
Interest expense				
Interest cost of bonds and notes	1,854,258	2,113,130	5,789,172	6,242,836
Interest on notes payable to Associations and others	40,140	45,846	82,174	84,464
Total interest expense	1,894,398	2,158,976	5,871,346	6,327,300
Net interest income	223,181	249,995	760,906	641,126
Provision for loan losses	468,983	36,007	675,910	77,407
Net interest income (loss) after provision for loan losses	(245,802)	213,988	84,996	563,719
Other income				
Loan service fees and other income	46,915	12,464	74,479	96,422
Other expenses				
Salaries, wages and other employee benefits	42,356	38,372	123,542	115,051
Financial assistance to Associations	149,350	-	163,152	-
Provision for losses on acquired property	76,000	1,513	99,504	2,899
Occupancy, equipment and other operating expenses	22,192	28,084	85,081	83,275
Compensation to Associations for originating and servicing loans	33,694	32,052	114,451	95,846
Total other expenses	323,592	100,021	585,730	297,071
Net income (loss)	$ (522,479)	$ 126,431	$ (426,255)	$ 363,070

THE 37 FARM CREDIT BANKS
COMBINED CONDENSED STATEMENT OF CHANGES IN CAPITAL

(In Thousands of Dollars)

	For the 9 Months Ended September 30,	
	1985	1984
	(Unaudited)	
Beginning balance	$9,242,349	$8,969,381
Net income (loss) for the period	(426,255)	363,070
Capital stock and participation certificates issued	216,012	264,530
Capital stock, participation certificates, and surplus retired	(489,251)	(313,350)
Balance at September 30	$8,542,855	$9,283,631

THE 37 FARM CREDIT BANKS
COMBINED CONDENSED STATEMENT OF CHANGES IN FINANCIAL POSITION

(In Thousands of Dollars)

	For the 9 Months Ended September 30,	
	1985	1984
	(Unaudited)	
Financial resources were provided by:		
Net income (loss)	$ (426,255)	$ 363,070
Charges to income not affecting resources:		
Provision for loan losses	675,910	77,407
Depreciation and amortization	22,168	(7,544)
Provision for losses on acquired property	99,504	308
Total provided by operations	371,327	433,241
Consolidated systemwide bonds issued	20,235,454	28,562,886
Consolidated systemwide notes issued, net	2,571,383	702,394
Decrease in loans	5,671,407	-
Decrease in accrued interest receivable	310,410	-
Increase in other liabilities	303,436	192,250
Total	$29,463,417	$29,890,771
Financial resources were used for:		
Consolidated systemwide bonds retired	$26,251,696	$28,869,673
Consolidated Bank and other bonds retired, net	460,372	25,709
Increase in loans	-	204,521
Increase in investment securities and cash	1,862,740	421,623
Increase in accrued interest receivable	-	71,965
Increase in other property owned	472,504	185,697
Additions to premises, equipment and other assets, net	142,866	62,763
Capital stock and participation certificates retired, net	273,239	48,820
Total	$29,463,417	$29,890,771

THE 37 FARM CREDIT BANKS

NOTES TO COMBINED CONDENSED FINANCIAL STATEMENTS
(In Thousands of Dollars)

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES:

The condensed 37 Farm Credit Banks combined financial statements include financial information of the 12 Federal Land Banks, the 12 Federal Intermediate Credit Banks, and the 13 Banks for Cooperatives at September 30, 1985 and for the 3 months and 9 months then ended. The condensed combined financial statements do not include the financial results of the Production Credit Associations and the Federal Land Bank Associations which are chartered under the provisions of the Farm Credit Act of 1971, as amended, but are not directly liable for Farm Credit bonds and notes. A complete description of the Farm Credit System, the accounting policies followed by the Farm Credit Banks, and their financial condition and results of operations as of December 31, 1984 is contained in the 1984 **Farm Credit Banks Report to Investors**, available from the Federal Farm Credit Banks Funding Corporation.

The accompanying unaudited quarterly condensed financial statements should be read in conjunction with the 1984 **Farm Credit Banks Report to Investors**. These financial statements contain all adjustments considered necessary for a fair presentation of the interim results subject to the resolution of the uncertainty relating to the adequacy of the allowance for loan losses as discussed in Note 3. Certain amounts in prior years' financial statements have been reclassified to conform to current classifications.

NOTE 2 - PROPOSALS FOR FEDERAL GOVERNMENT ASSISTANCE:

The Boards of Directors of the 37 Farm Credit Banks agreed at a meeting in September, 1985 to form a special Legislative Committee to seek Federal government assistance for the purpose of ensuring the System's continued viability. The Legislative Committee is developing proposals for Farm Credit System self-help and Federal assistance which are currently being discussed with the United States Government with a view towards agreeing on solutions for the System's problems.

NOTE 3 - ALLOWANCE FOR LOAN LOSSES:

An analysis of the allowance for loan losses included in the accompanying financial statements for the 3 months and 9 months ended September 30, 1985 and 1984 follows:

	3 Months Ended September 30,		9 Months Ended September 30,	
	1985	1984	1985	1984
Balance at beginning of period	$ 745,141	$673,052	$ 697,533	$665,437
Provision for loan losses	468,983	36,007	675,910	77,407
Loans charged off, net of recoveries	(158,584)	(40,161)	(317,903)	(73,945)
Other	33,485		33,485	
Balance at end of period	$1,089,025	$668,898	$1,089,025	$668,898

The provision for loan losses is based in part on a special credit review of Federal Land Banks which was completed in September, 1985. In addition, the Farm Credit Banks have analyzed agricultural economic conditions and trends and their potential impact on the Banks. This analysis was based upon economic studies conducted by the U.S. Department of Agriculture and the Farm Credit Administration. As a result of projected continuing deterioration in farm income and land values, the Farm Credit Banks may be exposed to loan losses aggregating $3.0 billion or more during the 1985-1987 period for which an allowance for loan losses of $1.089 billion has been established as of September 30, 1985. The Farm Credit Banks will make appropriate additions to the allowance for loan losses in the fourth quarter of 1985 based upon a detailed analysis of the loss exposure in the Banks' individual loan portfolios.

FARM CREDIT BANKS
FINANCIAL COMMENTARY
SEPTEMBER 30, 1985

Highlights

Significant financial developments for the three months and nine months ended September 30, 1985 included:

- The combined Farm Credit Banks incurred net losses of $522.5 million and $426.3 million for the three months and nine months ended September 30, 1985, respectively, compared to net income of $126.4 million and $363.1 million recorded for the same periods in 1984.
- Total capital of the Farm Credit Banks at September 30, 1985 was $8.5 billion, a decline of $0.7 billion from the December 31, 1984 level.
- The provision for loan losses for the first nine months of 1985 was $675.9 million; net loan charge-offs during the period amounted to $317.9 million. The provision for loan losses and net charge-offs for the comparable period in 1984 were $77.4 million and $73.9 million, respectively. The allowance for loan losses at September 30, 1985 was $1,089.0 million compared to $745.1 million at June 30, 1985 and $697.5 million at December 31, 1984. As discussed in Note 3 to the accompanying financial statements, the adequacy of the provision and related allowance for loan losses is currently being analyzed.
- Total risk funds for the 37 Farm Credit Banks, consisting of capital stock, surplus and the allowance for loan losses was $9.6 billion at September 30, 1985 compared to $10.0 billion at December 31, 1984.
- Net loans outstanding of the Farm Credit Banks were $70.7 billion at September 30, 1985, a decrease of $3.3 billion or 4.4 percent from the amount outstanding at June 30, 1985, and a decrease of $6.3 billion or 8.2 percent from December 31, 1984.
- Farm Credit securities outstanding decreased to $68.3 billion at September 30, 1985, compared to $70.0 billion outstanding three months earlier and $72.2 billion at December 31, 1984.

Commentary

The net loss in the third quarter of 1985 is principally due to the effect of the increase in the provision for loan losses, primarily in the Federal Land Banks (FLBs), and financial assistance provided to Production Credit Associations (PCAs).

The provision for loan losses of $469 million for the three months ended September 30, 1985 and $676 million for the first nine months of 1985 increased from $36 million and $77 million, respectively, during the same periods in the prior year. The combined Farm Credit Banks' allowance for loan losses to loans ratio increased from 1.0 percent at June 30, 1985 to 1.5 percent at September 30, 1985.

The provision for loan losses during the third quarter is directly related to the increase of $1.5 billion in nonaccrual loans which resulted from recognition of potential losses identified in a special credit review of the FLBs completed by the Farm Credit Banks in September 1985, and the resulting reclassification of loans 90 days or more past due, on which interest was being accrued. Consistent with their accounting policies, the Farm Credit Banks are continuing to accrue interest on certain loans which were 90 days or more past due on the basis that they are well secured. The principal balance of such loans at September 30, 1985 was approximately $1.6 billion.

Loans in nonaccrual status increased to $3.5 billion or 4.9 percent of loans outstanding at September 30, 1985 compared to $2.0 billion or 2.7 percent of loans outstanding at June 30, 1985. Other property owned, acquired as a result of loan foreclosures, increased during the third quarter to $694 million at September 30, 1985 from $580 million at June 30, 1985. This increase is due to foreclosure activity and the relative difficulty of selling acquired properties in the saturated farm real estate markets of several districts. Other expenses for the nine months ended September 30, 1985 included a $100 million provision to recognize declines, subsequent to acquisition, in the value of other property owned. Such provision was not significant in the comparable prior period.

The special credit review of the FLBs indicated that approximately $6 billion of the FLBs' $48 billion of loans outstanding are currently undercollateralized to the extent that the loan amounts exceed the current estimated market value of the real estate collateral. As of the date of the review, the amount by which the outstanding balance of these loans exceeded the collateral values approximated $900 million. While many of the undercollateralized loans are now current as to the payment of principal and interest, some are expected to generate significant future losses.

As described in Note 3 to the accompanying financial statements, the Banks may be exposed to aggregate loan losses of $3.0 billion or more during 1985 and the next two years. System Banks are analyzing their loan portfolios in order to determine whether additions to the allowance for loan losses are necessary.

With respect to the increase in financial assistance to PCAs, the Boards of Directors of the System's Banks approved a financial assistance plan for the FICB of Omaha and its related PCAs in August 1985. Under the plan, the participating Farm Credit Banks made $75 million in loss sharing payments to the FICB of Omaha in September, 1985. The FICB of Omaha contributed the $75 million received from the participating Banks and $50 million of its own funds to its most financially-troubled PCAs. Such amounts were charged to expense in the third quarter. If certain conditions are satisfied, the plan will also require the participating Banks to purchase, through the Farm Credit System Capital Corporation, approximately $240 million of high risk assets of the Omaha District PCAs in late 1985 or early 1986.

Financial difficulties continue to be experienced by PCAs whose results, although not included in the combined Farm Credit Banks' financial statements, have a significant impact on the financial condition of the FICBs. The combined PCAs are expected to incur significant operating losses during 1985 following net losses of $116 million before distribution of FICB earnings in calendar year 1984. PCA combined loan losses for 1985 are projected to be approximately $500 million compared to the 1984 level of $285 million. Due to the severely weakened financial condition of PCAs in several districts, it is possible that additional financial assistance will be required to be provided by the respective FICBs during the fourth quarter. In addition, several Farm Credit districts are currently developing plans to merge the PCAs in a district into one or more larger PCAs to centralize management and to pool capital and other resources. Such mergers were approved by the PCA stockholders in the Spokane and Jackson districts during the 1985 third quarter. PCA stockholders in a number of other districts are expected to vote on such merger plans before the end of 1985.

The combined Banks have taken steps to improve their liquidity position, including establishment of a centrally-managed investment pool in which substantially all Banks are participating. Investment securities and cash held by the Banks and in this investment pool at September 30, 1985 increased to $5.3 billion, a 55 percent increase over the December 31, 1984 balance.

The Banks' capital position of $8.5 billion at September 30, 1985 consisted of $4.9 billion of capital stock and participation certificates and $3.6 billion of surplus. The decline of $651 million in total capital since June 30, 1985 is primarily due to the $522 million net loss recorded in the third quarter and net stock retirements resulting from reduced loan volume. As described in the 1984 **Farm Credit Banks Report To Investors**, the capital structure of the Farm Credit Banks, as member-owned cooperatives, differs substantially from other commercial financial institutions because the issuance and retirement of capital stock and participation certificates are directly related to the lending activities of the Banks.

Outlook

Agricultural economists, both within and outside the Farm Credit System, project that current negative trends in the U.S. agricultural economy will continue in the near term. Accordingly, significant increases in non-earning assets and loan losses are expected through the remainder of 1985 and the next two years. Based upon the economic projections referred to above, the Farm Credit System may have to deal with non-earning assets aggregating more than $10 billion over the next several years. Competitive pressures and the weakened financial condition of the System's borrowers may preclude the Banks from increasing interest rates to offset the factors having negative effects on the combined Banks' earnings.

In reflecting new information concerning the System's loan portfolio in the third quarter results, the Banks' early September estimate of the possible operating loss for calendar year 1985 was exceeded during the first nine months. Additional losses are anticipated during the fourth quarter of 1985. However, the magnitude of such losses is dependent upon the resolution of the uncertainties discussed above with respect to the adequacy of the Banks' allowance for loan losses. System officials are presently discussing with representatives of the United States government proposals to address the System's problems through the utilization of the System's own resources and Federal assistance.

THE 37 FARM CREDIT BANKS
SELECTED FINANCIAL RATIOS

	For the 3 Months Ended September 30,		For the 9 Months Ended September 30,	
	1985	1984	1985	1984
Return on average assets	(2.57)%	0.59%	(0.69)%	0.57%
Return on average capital	(23.57)	5.47	(6.27)	5.31
Net interest income as a percent of average earning assets	1.16	1.22	1.29	1.05
Net charge-offs to average loans	0.87	0.20	0.56	0.12

	September 30, 1985	December 31, 1984
Allowance for loan losses to loans	1.52%	0.90%
Capital to loans	11.89	11.88
Debt to capital (:1)	8.43	8.18

Statement by
Gene Swackhamer, President
Farm Credit Banks of Baltimore
and Member of the Legislative Committee of
The Farm Credit Council

Mr. Chairman:

My name is Gene Swackhamer. I am President of the Farm Credit Banks of Baltimore. I am pleased to appear before this Subcommittee today as a member of The Farm Credit Council's Legislative Committee.

Mr. Chairman, today we are seeking the assistance of Congress and the Federal government to avert two potential crises of serious proportion for American agriculture and the nation's economy.

The first is a potential **funding** crisis and the need to immediately restore investor confidence in the Farm Credit System and the securities it must sell to fund one-third of the nation's farm debt and one-half of the farm real estate debt.

The second is a potential **financial** crisis as the precipitous decline in farm real estate values and lack of farm business profitability depletes the financial resources of Farm Credit banks, associations and their farmer-stockholder-borrowers. These conditions further compound the problems of a downward spiraling farm economy leading to a crisis of confidence by farmer-borrowers and their cooperatives in the Farm Credit System. The System's deteriorating financial position leads directly to questions of Farm Credit System reliability as a source of credit at reasonable rates.

Jim Roll has already described how Wall Street has reacted to the System's problems. In the space of three months, Farm Credit securities have gone from a better-than-AAA investment to being described by an article in the

October 28th Washington Post as "junk bonds". This story and a related one revealing that Standard and Poors had under consideration a change in their rating of System securities have heightened investor concern about System viability, absent government financial assistance.

The ripple effect of a Farm Credit System default on farmers, the financial markets and on our Nation's economy in general would be devastating. Chase Econometrics is analyzing this issue in some detail for us and their preliminary findings show an impact more on the order of a tidal wave than a ripple.

A System default would mean that almost 90,000 additional farm operators would have their loans foreclosed in the first year after default on System obligations. Interest rates paid by farmers likely would increase by 3 1/2 - 4 1/2 percent and there likely would be a $22 to $39 billion credit shortfall to meet agricultural production expenses.

Because of their holdings of Farm Credit securities, the 3,900 agricultural banks throughout rural America would lose over a third of their capital. As a whole, the Nation's banking industry would lose close to 10% of its capital in the first year and would experience additional losses as other agricultural loans go bad.

Secondary economic impacts are no less dramatic:

- -- interest rates outside agriculture likely would increase by 2 1/2 - 3 percent, resulting in slower growth in the economy,
- -- an estimated 1.5 million jobs would be lost,
- -- an increase of $53 billion in the Federal deficit.

Shocks to the economy of the nature being estimated in this study can be prevented with explicit government guarantees and financial assistance. The first requirement is to stabilize the market for System obligations. This will ensure the continued flow of capital to farmers through the Farm Credit System, while it reduces System funding costs and helps prevent significant and devastating increases to farmer interest rates.

In my opinion, this will calm Wall Street. But, the Chase study confirms that the reasons for allaying Wall street concerns about the quality of Farm Credit investments extend far beyond the System and the farm economy.

We have considered the usefulness of Federal guarantees on System securities. It is only a partial solution. It does not ensure that the System will have the capital resources necessary to permit restructuring of nonperforming loans, holding of liquidated property off the market or absorbing significant loan losses without forcing the System to substantially raise interest rates!

The second problem that we must face is how to solve the critical financial problems of farmers and their Farm Credit System. According to USDA's data, as of January 1985, farmers leveraged greater than 40 percent who also had negative cash flows in 1984 owed the System $18.7 billion. Those in the most immediate trouble--having both a debt/asset ratio of greater than 70 percent and negative cash flow--reported that they owed the System $8.6 billion from borrowers leveraged over 70 percent with negative cash flow. The System will incur significant losses which will further deplete the System's capital, regardless of the efforts made to collect the loans.

At year-end 1984, the 37 Farm Credit Banks, together with the production credit and Federal land bank associations, had total risk funds--capital and loss reserves--of $13.1 billion with non-accrual assets amounting to $2.5 billion. By September 30, 1985, risk funds had dropped to $12.8 billion and non-accrual assets had jumped to $5.3 billion. By the end of 1985, we project that non-accrual loans will reach $6 billion. The magnitude of the loss for calendar 1985 is dependent on the necessary addition to the allowance for loan losses which will result from loan portfolio studies currently being performed.

In all, as Jim Roll testified, we expect that some $13 billion in loans now outstanding will fall into non-accrual status in the next two years. Even with aggressive management of troubled loans, the level of loans in non-accrual status is now forecasted to reach $11.0 billion by December 31, 1987, at which time risk funds of the System are projected to have fallen to $6.9 billion. Of that $6.9 billion, however, $4.9 billion will be farmer-invested stock. In other words, at that point in time, if all the surplus and loss reserves of the 37 banks and over 700 associations were combined into one account, the System would have to net $9 billion in recoveries on $11 billion in non-accrual loans to avoid the impairment of farmer-borrower stock throughout the System. Given the current condition of the agricultural economy and the required rapid movement of land onto already depressed real estate markets, it is very unlikely that the System can avoid significant impairments of farmer/borrower stock.

Frankly, we do not think it is very likely that the System could endure through 1987. With rising loan losses, increasing costs of carrying non-earning assets resulting in successive years of **multi-billion dollar operating losses** System-wide, we believe the investors would abandon the System prior to year-end 1987, without government financial assistance!

Even if the Federal government can give some assurance to the financial markets, an equally serious problem remains for the System's farmer-stockholders. The flight of some borrowers who have the financial condition which permits them to seek another lender will do so if the government does not assist the System. This, too, hastens the ultimate financial collapse of the System as farmers' capital is withdrawn.

Mr. Chairman, as we considered various options for government assistance, we have been ever-mindful that almost $11 billion of the $13 billion in nonaccrual loans expected by the end of 1987 will surface from within the Federal land bank portfolios. As the holder of one-half the U.S. farm real estate debt we are greatly alarmed by the likely consequences upon the farm real estate values and the total farm economy if the land banks having almost 20 percent of our loans in the process of liquidation in the next two years!

This underscores the unique role and responsibility of the Farm Credit System in relation to the farm economy. It is on the basis of this special role and responsibility that we call upon the Congress to once again join with the Farm Credit System in a program of System self-help and government assistance to help farmers, ranchers and their cooperatives through this most difficult period for American agriculture.

The objective of our proposal is brief: to help restore stability to farmland values and to assure farmers, ranchers and their cooperatives that credit will continue to be available at a reasonable cost through the farmer-owned and directed Farm Credit System.

We stand ready to work with you and your staff in preparing and perfecting draft amendments to the Farm Credit Act that would permit these farmer-owned institutions to implement self-help measures through the Farm Credit System Capital Corporation as mentioned earlier by Mr. Tucker.

The Capital Corporation is a service corporation chartered by the 37 Farm Credit Banks in 1985 for the purpose of mobilizing System resources and overseeing System financial assistance to the Omaha and Spokane Federal Intermediate Credit Banks and their related associations.

We believe that the concept of System self-help embodied in the activities of the Capital Corporation is sound and that if the Farm Credit Administration is authorized to supplement the resources of that Corporation through temporary loans, it is the most efficient vehicle to aid the farmer-owned and directed Farm Credit System. It is in place, operating and, we believe, with minor additions to its authorities, it could readily be used to facilitate a program of assistance for troubled institutions of the System while also moderating the otherwise extreme effects of rapid adjustment that is occurring in U.S. agriculture.

The Proposal

Specifically, our proposal would:

o Empower the Farm Credit System Capital Corporation to serve as a financial warehouse through which System institutions and government would share in the mounting costs of carrying non-accrual loans and acquired properties marked to economic value, and in other temporary financial assistance essential for the survival of troubled farmer-owned System institutions.

o Authorize the Capital Corporation to mobilize available System capital through assessments on System institutions, consistent with standards to be established by the Farm Credit Administration. These standards would guard against undue increases in interest rates to farmers in contributing districts, and so that district institutions can plan for their own financial affairs, such annual assessments could not exceed one-half of one percent of interest accruing assets.

o Incorporating moneys available through FCA's present revolving funds, authorize FCA to immediately supplement System financial self-help measures through a provision for loans from the U.S. Treasury of up to $6 billion, not to exceed $2 billion in any fiscal year.

o Require the System to repay assistance with interest through assessments by the Capital Corporation as System institutions are able to repay consistent with regulatory standards established by FCA.

o Require, consistent with conditions of prior Federal Assistance to the System, the payment of annual fees equal to the Government's cost of funds or 25 percent of System earnings, whichever is the lesser, for so long as such loans are outstanding.

o Maximize local accountability by requiring that as a condition of assistance through the Capital Corporation, a troubled bank or association shall have first reasonably drawn upon the financial resources of other institutions within its district.

o Supplement the existing powers of the Capital Corporation to provide it with the operational tools and flexibility that are necessary to carry out its broadened responsibilities.

o Provide for the continued local loan administration, restructuring and management of troubled loans, related assets and acquired property.

o Cause FCA to set regulatory guidelines for loan restructuring and property management taking into account such things as local farm real estate market conditions, production value of real estate collateral, conditions under which foreclosed property may be leased back to qualified borrowers, terms under which System institutions will secure the amount of any deferred principal through participation in future appreciation of collateral or other means. Such guidelines would be implemented in policies of the Capital Corporation and would apply in districts which receive inter-system or Government assistance.

o Authorize FCA to increase legal debt to capital limits for PCAs (now 10 to 1) to up to 20 to 1 thus avoiding many otherwise necessary liquidations of troubled PCAs.

In addition, we recognize that as a part of any Federal financial assistance, the public must be assured of the safety and soundness of its investment in the System. As a part of any such assistance, the System will support legislation which will provide enhanced regulatory powers for the Farm Credit Administration, coupled with a withdrawal of the agency from participation in management and business policy determinations of System institutions. We believe that the enforcement powers of the FCA should be no less than, but neither should they be greater than, those exercised by other Federal regulators of financial institutions.

Benefits

With these additional authorities and with financial assistance from the Federal government:

o **Farmers benefit** as costs of carrying non-accrual assets are shifted off the books of troubled banks and associations; and costs of System borrowing are reduced as investor confidence is restored, thus reducing pressure on interest rates.

- **Farm foreclosures and bankruptcies are minimized** as a direct result of financial assistance that permits more orderly and reasonable workout and restructuring alternatives under FCA regulatory guidelines.

- **Farm land values are stabilized** as financial assistance in carrying non-earning assets relieves the pressure on troubled institutions to rapidly sell properties in inventory. By restructuring troubled loans to reflect production values for farm real estate collateral, System institutions will signal the market that an underlying value is being established for farmland by the nation's principal farm real estate lender.

- **Farm Credit System can continue** as a viable and dependable provider of credit and related services at reasonable costs-owned by and dedicated exclusively to serving U.S. farmers, ranchers and their cooperatives.

The Impact of No Assistance

As single industry lenders with their loan assets totally dependent upon a rapidly deteriorating farm economy, the banks and association of the Farm Credit System are being squeezed in a financial vise: with rising costs of funding and increasing levels of non-accrual assets they can either raise interest rates to farmers--a substantial portion of whom cannot pay the present rates. This further aggravates the financial plight of those who cannot refinance and drives away those who can. As interest rates increase, the System's capital and earnings base erode. And as the institution feeds on itself, the investors demand ever higher rates until they finally quit purchasing System securities entirely.

Faced with these alternatives, and absent government financial assistance, System banks and associations will be forced to minimize the rate of capital erosion by:

o Accelerating the collection of delinquent loans to minimize the burden on non-earning assets.

o Increasing interest rates to borrowers to cover the higher costs of purchased money and the carrying costs of non-accrual loans and acquired property.

o Aggressively marketing inventoried properties, resulting in additional stress on the already depressed and soft farm real estate markets.

o Pressing forward with widespread consolidations of associations to most efficiently utilize capital remaining within the System.

Finally, the Farm Credit Administration has indicated that without financial assistance:

o at least 40 production credit associations will be liquidated or forced to consolidate within a few months,

o as many as three Federal intermediate credit banks, and o two Federal land banks will meet the same fate within a year. The result would be serious loss of confidence and stockholder investments by hundreds of thousands of the System's farmer and cooperative borrowers.

Mr. Chairman, the System-wide obligations which fund the operations of the Farm Credit System are the joint and several obligations of the 37 Farm Credit Banks. We are in debt together and the inability of the System to market those securities could bring the total of the System to its knees in less than three weeks. This fact often masks the reality that these banks and associations are not a single institution, but rather, they are a group of farmer-owned and farmer-directed, locally based farm lending cooperatives knit together by a common charter Act, a common regulator and their co-responsibility on obligations issued through a common funding source. Thus, absent a collapse of the bond market, the financial problems facing the system will not bring it crashing down all at once. At an accelerating pace, however, individual institutions will fail, association by association, and then bank by bank.

It must be emphasized though, that the farmers and cooperatives who borrow from these institutions own them as well. They are the ones who would be helped most by assistance to these institutions. The converse of this statement, though, is just as true. Those who will be hurt most should the Farm Credit System not receive financial assistance will be those same borrowers and owners of the Farm Credit System banks and associations--some one million U.S. farm families.

We believe it is imperative that steps be taken in this session of the Congress to restore both farmer and investor confidence in the Farm Credit System. We dare not leave the financial markets unsettled while Congress is in recess, and farmers must be assured _now_ that their Farm Credit System will continue as a dependable provider of credit and related services in 1986 and beyond. We believe that a mechanism for financial assistance must be in place _before_ farmers come in to set up their loans in January.

For The Farm Credit Council and its member banks and associations of the Farm Credit System, we offer these proposals for your urgent consideration. As you consider them, we urge you to remember why your predecessors in the Congress established the Farm Credit System, the excellent record of service to agriculture and the fact that the System has already proven its credit record with government. It has repaid its government capital in the past. It will again.

STATEMENT
OF
ALAN TUBBS
THE AMERICAN BANKERS ASSOCIATION

Mr. Chairman and Members of the Committee, I am Alan Tubbs, President of First Central State Bank, DeWitt, Iowa. I am representing the American Bankers Association, and I am the immediate past Chairman of the Executive Committee of the Agricultural Bankers Division of the American Bankers Association. The combined assets of our nearly 13,000 member banks represent approximately 95% of the industry total. While our members range in size from the smallest to the largest banks, approximately 85% of them have assets of less than $100 million.

Mr. Chairman, farmers, agricultural banks, and the Farm Credit System all are facing the same deteriorating agricultural economy. In the history of this country, farm problems are not unusual. In most cases, these problems are corrected by normal economic cycles which cause the agricultural industry to rebound and recover. However, this time we have some structural changes occurring within the agricultural industry that normal economic cycles will not correct without massive social and economic dislocation. These problems threaten the existence of a significant percentage of farms and an unknown but growing number of agriculture-related banks and businesses.

Economic problems of a size not seen by generations of Americans are wrenching farm life and rural communities across the country's principal food-producing regions. Evidence is mounting that fear and despair are spreading among hundreds of thousands of farmers who are looking at millions of acres of farms likely to fall into the hands of creditors. These farmers are among the nation's more than 2 million farmers who are struggling to pay interest on total liabilities that have soared 63% since 1979, from $132 billion to $215 billion in 1985. The interest now totals more than $21 billion a year, while net farm income is projected to drop by

28% from 1984 ($34.5 billion) to 1985 ($25 billion). Further, this economic data cannot convey the personal signs of the severity of the problem that have been evident over the last few months in visits and telephone interviews that I have had with farmers, bankers, and rural merchants.

We are here today to discuss once again the deteriorating agricultural credit situation. We all know, also, that a particular focus of this hearing is the current status of the Farm Credit System (FCS) and proposals for its assistance. I must stress that the ABA did not have access to any of the specifics of any FCS proposal for assistance during the preparation of our testimony. However, the ABA has been following the situation.

Let me assure the committee that the ABA does recognize the severity of the problems facing the FCS. We empathize because agricultural bankers face the same problems: declining farm income and asset devaluation that result in intensified farm credit problems.

We recognize that the basis of the farm financial problem is declining income, and that credit cannot be substituted for income. As I stated earlier, we are witnessing a structural transformation of our agricultural industry, which is now over-capitalized based on income projections for the foreseeable future. In this context, farmers, agricultural suppliers and creditors must be given time to adjust to the current environment of deflation of assets, high real interest rates, and the over-priced dollar. For that reason the ABA commends this committee for its diligent work on the 1985 Farm Bill. There are no easy answers, no quick solutions, only different proposals for sharing the pain.

But we are here today to focus on credit and the Farm Credit System. The ABA supports the survival of the FCS and recognizes that Federal assistance may be necessary. But we urge the committee to view the agricultural credit situation and the Farm Credit System's proposals for assistance from two perspectives. First, survival of the System is a short term goal of both the System and agricultural bankers. Second, however, any Congressional response to this short term goal has long term implications for the role of the FCS in relation to commercial banks and the structure of agricultural financing in the future. These implications cannot be ignored.

ROLE OF THE FARM CREDIT SYSTEM

The ABA has testified before this committee numerous times to object to an ever-broadened mandate for this cooperative financial institution. ABA testified four times before the House and Senate during hearings on the System's proposals for expanded authority in 1979 and 1980. We also expressed our concern about lax regulation by an agency, the Farm Credit Administration, that was not independent. During the mark-up of the Farm Credit Act Amendments of 1980, members of the House Agriculture Committee noted their concerns about the liberalizing amendments that were passed. However, they were passed. The Farm Credit System then began a major study of its future, its structure, and its role in agricultural finance titled "Project 1995".

Today, the Congress is faced with a very difficult situation concerning this same FCS. The System is requesting a major assistance package and implying that if assistance is not approved within a very short time that total collapse of this large financial institution will result.

From one perspective, this is obviously the worst time to raise the question of what the role of the Farm Credit System should be. But from another perspective, it is precisely the time at which this question must be asked. If the question is not asked, and if the Congress responds with an assistance package, then the Congress will be affecting the long term picture of agricultural credit in this country without assessing the goal which it finds most acceptable for the System that it is assisting and for which it is responsible.

There are internal changes going on within the Farm Credit System that are remaking the System's structure, changing the locus of decision-making, and potentially increasing the range of services offered in competition with agricultural banks and other lenders. These changes are going on, and there is a game plan outlined in "Project 1995" for these changes. If the Congress does not consider the role that it wishes the Farm Credit System to play in agricultural lending as it develops an assistance package, it will be confirming, by default, the role which the Farm Credit System has chosen for itself.

The System is developing that role and it is becoming much more centralized. Over time, if assisted without limitations, if, in effect, rewarded for its difficulty, it can become aggressive again. Private agricultural banks welcome competition, but it must be fair competition. Competition from a Federally-assisted non-bank bank seeking to offer additional services while retaining special access to the credit market is unfair.

The American Bankers' Association acknowledges the importance of the Farm Credit System and recognizes the need for assistance. However, we do not believe that assistance should be offered by the American taxpayer without some significant changes in the operation of the System designed to target and limit its activities, tighten its district-level management to protect the soundness of the System, and strengthen and make independent its regulator.

In addition, since the System is a cooperative with privileged access to the credit markets due to its Federal agency status, which results in the market's perception of Federal backing, the Congress should consider how the System's role as a cooperative lender is going to be pursued in the future. Otherwise, the System will retain its tax advantages as a cooperative and credit market advantages as a quasi-governmental agency, receive new Federal assistance due to its financial difficulties, and yet be able to continue its restructuring and redefinition of its role unchecked. As this committee certainly knows, there is considerable objection to many current FCS policies (such as consolidation and foreclosure) based on the argument that these actions are not consistent with a cooperative enterprise, controlled by farmer-borrowers at the local level.

If the Congress determines that the direction in which the System is now going does not fit the role deemed appropriate for a cooperative agricultural lender, then changes and limits should be applied to any legislation providing short term assistance for the System. Careful strictures applied to the System will define its role for the long term future. Such strictures should be applied now when the assistance is being requested from Congress and the general public.

Since the FCS was first set in place, numerous changes have occurred in the financing of agriculture, including increased participation by the private sector. For example, banks had 14% of the loan volume outstanding in 1940, but had 24% of all agricultural loans outstanding this year according to the Federal Reserve. We believe the appropriate role of the

FCS has changed, and that this role should be re-evaluated by the Congress. Such an evaluation, we believe, will demonstrate that a greater reliance on the private sector will best meet the future needs of the agricultural economy.

CRITERIA FOR EVALUATION OF FARM CREDIT LEGISLATION

The ABA has developed criteria for the evaluation of farm credit legislation. I shall present each one and discuss it briefly.

- A strong, independent regulatory agency must be established for the Farm Credit System. The ABA strongly supports the development of an FDIC-like agency for the regulation of the Farm Credit System. Whether that agency is a totally remade Farm Credit Administration or some other body is not of fundamental concern. Our primary concern is that the regulatory agency be independent and function vis-a-vis the Farm Credit System in the same manner as the bank regulators function vis-a-vis banks. Simply giving additional regulatory power to the FCA is not sufficient; the FCA must be made independent with an independent board and no management responsibility for the System.

- Independent audits of the Farm Credit System and its components must be required. As a number of independent analyses by the General Accounting Office and various reporters have demonstrated, the Farm Credit System at present does not have careful, systematic, independent audits which would provide the type of consistent and thorough data required to craft legislative responses to its financial situation. The failure to have independent audits is also a management shortcoming that harms management ability to make decisions. Independent audits are an absolutely fundamental requirement, in our opinion, for any financial institution, but particularly for one directly overseen by the U.S. Congress.

- The Farm Credit System's capital requirements must be carefully defined and made comparable to those of other financial intermediaries. One of the major questions raised concerning assistance packages designed for the Farm Credit System is what is the extent of its capital and in what form is that capital held. These requirements are carefully defined for commercial banks and should be equally carefully defined for the Farm Credit System. The failure to specify these criteria would leave Congress without the type of information which it needs when dealing with this large financial institution and would leave the System without guidelines for the future.

- The Farm Credit System's internal practices assuring soundness must be made more stringent. Apparently, the Farm Credit System is now establishing internal practices nationwide to assure the soundness of the system in the future. However, there has been great variation between districts — on loan limits as a percentage of capital, for example. These requirements are established by bank regulators for banks and should be established for the entire Farm Credit System.

- Proposals for a short term response to the deteriorating agricultural credit situation should not confer long term competitive advantages on the Farm Credit System vis-a-vis commercial banks. This criterion is the logical corollary of the discussion earlier in this testimony of the importance of the Congress' consideration of the role that it wishes the Farm Credit System to play in agricultural financing in the future. Providing assistance only to the Farm Credit System confers a long term competitive advantage on the System by definition. The ABA believes strongly that a System that is today a major competitor to the private sector and which wishes to strengthen its competitive position in the future while still maintaining the benefits of a cooperative, quasi-governmental financial institution must be carefully examined by the Congress. Any short term assistance package must be targeted and limited.

- Any assistance package must provide equality of treatment for agricultural borrowers. The ABA objects to any short term response to the deteriorating agricultural credit situation which would disadvantage borrowers at commercial banks relative to borrowers from the FCS. Assistance to the FCS will naturally result in indirect assistance to the farmers who borrow from the FCS by relieving certain economic pressures on the System. We strongly believe that agricultural borrowers from other institutions should have the same opportunities as borrowers from the FCS. As stated earlier, agricultural banks are facing the same agricultural economy as the FCS. In addition, small, rural agricultural banks do not have the System's ability to share their losses with other parts of the institution in less financially-distressed areas of the country. The ability of agricultural banks to serve their borrowers is affected by loan losses just as is the ability of the FCS. All farm borrowers should be treated equally in any assistance package.

ASSET STABILITY

Because real estate constitutes 75% of total assets, changes in the value of farm land will dominate all changes on the asset side of the farm balance sheet. Farm sector assets have been decreasing since January, 1981. Most recent USDA figures show that Iowa farmland values have declined 49 percent since 1981.

Let me bring you up to date. It is common today to experience real estate value declines of 60 to 70 percent from peak values, and in my estimation this would translate into a capital loss in Iowa of $50 - $60 billion and nationally of over $250 billion.

Banks are having problems dealing with this kind of decline. We find a tremendous increase in the number of problem banks. The percentage of these banks that are agricultural banks has increased also. Recently it was announced that the FDIC problem bank list includes 1032 problem banks, up from 828 last year. That number could reach 1300 by year end. That is 10 percent of our nation's banks. Assisting farmers and lenders to stabilize assets can prevent some of the more extreme problems for rural communities. It can prevent farm failures and bank failures.

Mr. Chairman, the ABA has examined proposals for assistance that would help lenders work with their farmer-borrowers to stabilize asset values in this period of economic turmoil in agriculture. Three approaches seem particularly promising and worthy of further consideration. The ABA recognizes that legislation designed to respond to the problems of agricultural credit is likely to include some combination of approaches. The problems now endemic to the agricultural economy make for a complex and multi-faceted situation to which there will be no single, straightforward response. It is in this context that I present these three possible responses for your consideration and, we hope, further review.

- One approach is a debt restructuring plan designed to lower farmers' cashflow requirements. Agricultural bankers are willing to take part of the burden of restructuring debt in order to keep farmers on their farms and to keep land in the hands of farm families. A proposal which would have the Federal government, state government, and lenders participate in debt restructuring seems a very reasonable and workable solution for some farm families.

- A second possibility is some type of corporation or "warehouse" that could be designed to hold farm land off the market when loans on that land are no longer performing. Holding land off the market is a benefit because the more land that is placed on the market the more the market becomes depressed. Holding land off the market will help prevent a spiralling deflation of land prices. If some way can be found to emphasize the conservation aspects of this approach, agricultural bankers believe it has merit. But we also are very concerned about its potential cost and the amount of land which might end up in any such corporation. These are issues that should be very carefully examined if further consideration is to be given to this approach.

- A third option is some mechanism that would provide Federal backing which would allow the Farm Credit System and commercial banks to spread losses on agricultural loans over time. Such a mechanism would assist regulators as they examine these agricultural financing institutions. It should be carefully structured to provide time for lenders to practice forbearance with farmers so that both farmers and lenders have an opportunity to work out of their current financial difficulties. However, it should not simply guarantee continued existence for all institutions that are now in difficulty because of agricultural loans.

Mr. Chairman, members of the Committee, the ABA has been working diligently on the issues of agricultural credit for months and expects to continue to do so. There are no short answers to a problem that has been developing for the last fifteen to twenty years. We cannot say that we look forward with great joy to the opportunity to work with you on these problems because there is no joy in this situation. However, we respect your concern for the situation of the farmers and the lenders now involved in agriculture. We appreciate the opportunities that we have had for input and dialogue with this committee. We look forward to continuing this relationship and to working closely with you.

STATEMENT OF BUD GERHART, PRESIDENT, THE FIRST NATIONAL BANK, NEWMAN GROVE, NE, AND CHAIRMAN, AGRICULTURE-RURAL COMMITTEE, INDEPENDENT BANKERS ASSOCIATION OF AMERICA

Mr. Chairman and members of the Subcommittee, I am Bud Gerhart, Chairman of the Agriculture-Rural Committee of the Independent Bankers Association of America and President of the First National Bank, Newman Grove, Nebraska.

The IBAA is a national trade association representing about 7,500 local community banks, almost half of which are substantially committed to lending to crop farmers, ranchers, and other agricultural producers. Hundreds of those agricultural banks have 75 percent or more of their total loans devoted to farm production.

The commercial banks are the largest suppliers of operating credit to farmers, with about $40 billion of production credit, more than all other non-Federal sources combined. This production financing is vital for debt servicing purposes, since farmers cannot service real-estate debt, supplied mostly by the Farm Credit System, without adequate operating credit.

Farm loan losses are up substantially. In 1984, net charge-offs of farm production loans at commercial banks were 2.2 percent of total farm loans outstanding. For the first two quarters of 1985, net charge-offs are running almost double that rate.

With agricultural prices off 20-25 percent virtually across the board compared to a year ago, agricultural banks will find it more difficult to finance many farm borrowers. With the mounting backlog of nonperforming loans, it will be even more difficult to finance farmers in 1986.

To deal with the problems of farm debt and financing, the IBAA has emphasized two basic considerations:

First, establishing the highest possible level of farm commodity price and income supports in the farm bill on a multi-year basis is the most critical step in preventing more farmers from sliding into insolvency. Attached to this statement is a copy of our letter sent to all members of the Senate last week, recommending that, at a minimum, the farm income supports (target prices) must be maintained at existing levels for the next four years. Even this will not prevent the continued deterioration of the farm economy. Farmers must have adequate income to service debt. A farm program that improves prices and farm income will benefit farmers as well as lenders and may be less costly than massive Federal assistance to lenders.

To achieve this, we believe that farmers should have the right to decide whether they want to use mandatory production controls combined with higher price support loan levels during this period of depressed prices and overproduction.

Second, as various options are considered, it is very important that all lenders and their farm borrowers are treated equitably and accorded an equal opportunity to work their way out of the present difficulties.

Early in 1985, the Farm Credit System proposed an Agricultural Conservation Corporation which would have the authority to purchase farmland and "warehouse" that land for a period of time until land prices stabilized. A few weeks ago, the Farm Credit Administration announced that, the Farm Credit System would incur larger loan losses than the System could absorb and that they were considering various options for Federal assistance, including a warehousing arrangement which would hold both real estate and loans.

In response, IBAA convened a group of agricultural bankers from 20 states here in Washington on September 22-24 to develop recommendations whereby agricultural banks and their farm borrowers could be provided equal access to any Federal assistance which might be forth coming.

Specifically, we have recommended that any Federal assistance effort could be closely connected to an existing agency, the Farmers Home Administration, and might be limited to certain marginal changes in existing programs of the FmHA. We proposed that such an agency could be authorized to purchase both farmland and farm loans. Farmland would be subject to purchase only where it was already held in inventory by a lender. Loans could be subject to purchase at a discount, based on the value of the collateral securing the loan. The purpose of authorizing the agency to purchase either farmland or loans is to keep additional farmland, machinery and other farm assets from coming onto already-saturated markets and provide equitable treatment for both real estate and production lenders and their farm borrowers. Over time, as farm asset values stabilized, this purchasing and "warehousing" agency could resell these farmland and loan assets. This would have the merit of directly benefitting farm borrowers by reducing principal and interest. A summary of those recommendations is attached to this statement.

The attached October 17 letter includes our response to the Farm Credit System's recent effort to secure major Federal assistance on a unilateral basis. We would consider it patently unfair for commercial agricultural banks to be permitted to continue to fail in record numbers (since the 1930s), and at the same time relieve the cooperative Farm Credit System of its loan losses through a direct and unilateral infusion of money at reduced rates from the Federal Treasury. Furthermore, such an approach would not solve the problem of individual farmers in getting affordable operating credit for production purposes. We would instead prefer putting any available Federal funds into higher price and income supports in the farm bill, pending the development of farm debt restructuring plans which are equitable to all farm lenders and their farm borrowers.

Other steps can be taken to relieve some of the financial stress. We have recommended that the direct lending programs of the Farmers Home Administration continue to be fully available to first-time borrowers. FmHA's direct loan program will be vitally important in 1986 as in 1985.

The FmHA guaranteed loan program was used in 1985 for about 7,500 loans totaling approximately $1 billion.

A joint Federal-private lender interest rate buy down program can be used to reduce the interest rate on certain farm loans. The credit section of the general farm bill, as reported by the Senate Agriculture Committee, (S. 1714) provides $490 million of funds for a 3-year program involving FmHA guaranteed loans whereby the Federal government would match a 2 percent interest rate reduction by the commercial or cooperative lender with a 2 percent Federal contribution resulting in a total 4 percent rate reduction to the borrower. The $490 million would be sufficient to cover basically the entire funding authorization for FmHA guaranteed loans as provided in the Senate Committee's bill.

Each of these measures--the guaranteed loans, interest rate buydowns, and others, are equally available to Farm Credit banks and their borrowers, and to commercial agricultural banks and their borrowers.

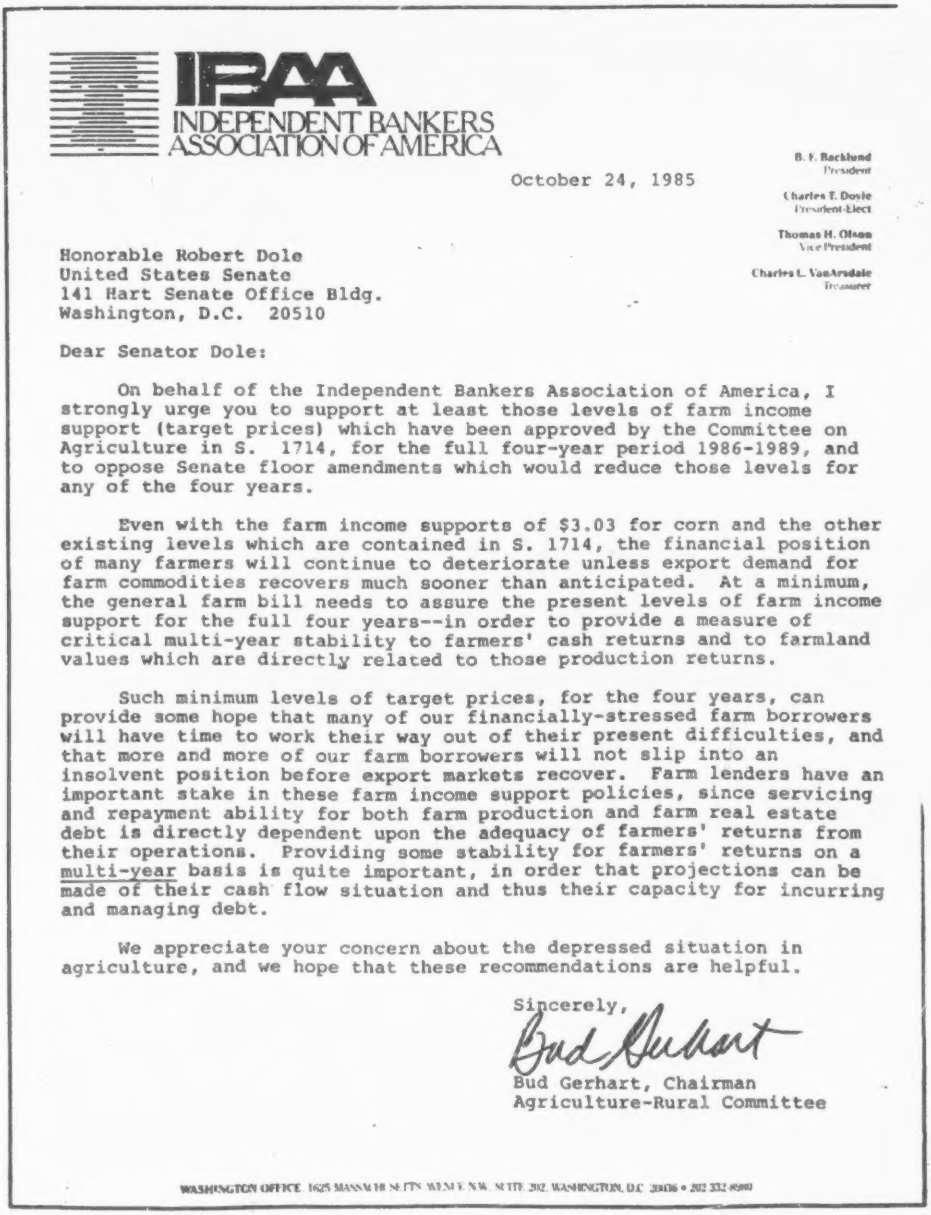
In summary, we continue to believe that the price and income supports in the general farm bill are the best way to assist financially-stressed farmers thus indirectly benefitting lenders. By taking some additional steps along the lines which we are recommending, and by considering other options, yet another tier of farmers might be prevented from slipping into insolvency. Keeping more of our good farmers from getting into financial trouble is our goal.

We cannot emphasize too strongly the need for the equitable treatment of agricultural banks and their farm borrowers, to keep that operating credit flowing and agricultural banks in a fully competitive and viable position.

This concludes my prepared statement, Mr. Chairman, and I would be pleased to respond to any questions.

(Attachments follow:)

Personalized to all members of the U.S. Senate



IBAA
INDEPENDENT BANKERS
ASSOCIATION OF AMERICA

B. F. Backlund
President

Charles T. Doyle
President-Elect

Thomas H. Olson
Vice President

Charles L. VanArsdale
Treasurer

October 24, 1985

Honorable Robert Dole
United States Senate
141 Hart Senate Office Bldg.
Washington, D.C. 20510

Dear Senator Dole:

On behalf of the Independent Bankers Association of America, I strongly urge you to support at least those levels of farm income support (target prices) which have been approved by the Committee on Agriculture in S. 1714, for the full four-year period 1986-1989, and to oppose Senate floor amendments which would reduce those levels for any of the four years.

Even with the farm income supports of $3.03 for corn and the other existing levels which are contained in S. 1714, the financial position of many farmers will continue to deteriorate unless export demand for farm commodities recovers much sooner than anticipated. At a minimum, the general farm bill needs to assure the present levels of farm income support for the full four years--in order to provide a measure of critical multi-year stability to farmers' cash returns and to farmland values which are directly related to those production returns.

Such minimum levels of target prices, for the four years, can provide some hope that many of our financially-stressed farm borrowers will have time to work their way out of their present difficulties, and that more and more of our farm borrowers will not slip into an insolvent position before export markets recover. Farm lenders have an important stake in these farm income support policies, since servicing and repayment ability for both farm production and farm real estate debt is directly dependent upon the adequacy of farmers' returns from their operations. Providing some stability for farmers' returns on a multi-year basis is quite important, in order that projections can be made of their cash flow situation and thus their capacity for incurring and managing debt.

We appreciate your concern about the depressed situation in agriculture, and we hope that these recommendations are helpful.

Sincerely,

Bud Gerhart

Bud Gerhart, Chairman
Agriculture-Rural Committee

WASHINGTON OFFICE 1625 MASSACHUSETTS AVENUE N.W. SUITE 202, WASHINGTON, D.C. 20036 • 202 332-8980

IBAA Farm Debt Recommendations
(Approved September 24, 1985)

The following are some components of the IBAA farm debt recommendations:

1. A new corporate unit could be established, either as a subsidiary to the Farmers Home Administration of the USDA or a separate and free-standing entity.

2. This corporation would be authorized to purchase troubled assets from lenders--commercial agricultural banks and Farm Credit banks--of two types:

   a) real assets (primarily farmland) already held in inventory by agricultural lenders; and

   b) troubled farm loans held by agricultural lenders.

3. Eligibility of specific loan cases for purchase would be based upon selection criteria applied to individual farm borrowers, or the degree to which the bank lender is committed to agricultural lending--or a combination of these.

4. The corporation would compensate lenders for real assets (essentially farmland) based upon the full appraised value of the farmland.

5. The corporation would purchase problem loans on a whole-credit-line basis, so that the entire outstanding debt owed to a commercial agricultural bank or Farm Credit bank would be transferred. All collateral and claims on receivables standing behind the transferred loan would move with the borrower to the corporation.

6. Regarding compensation of existing lenders for loans purchased by the corporation:

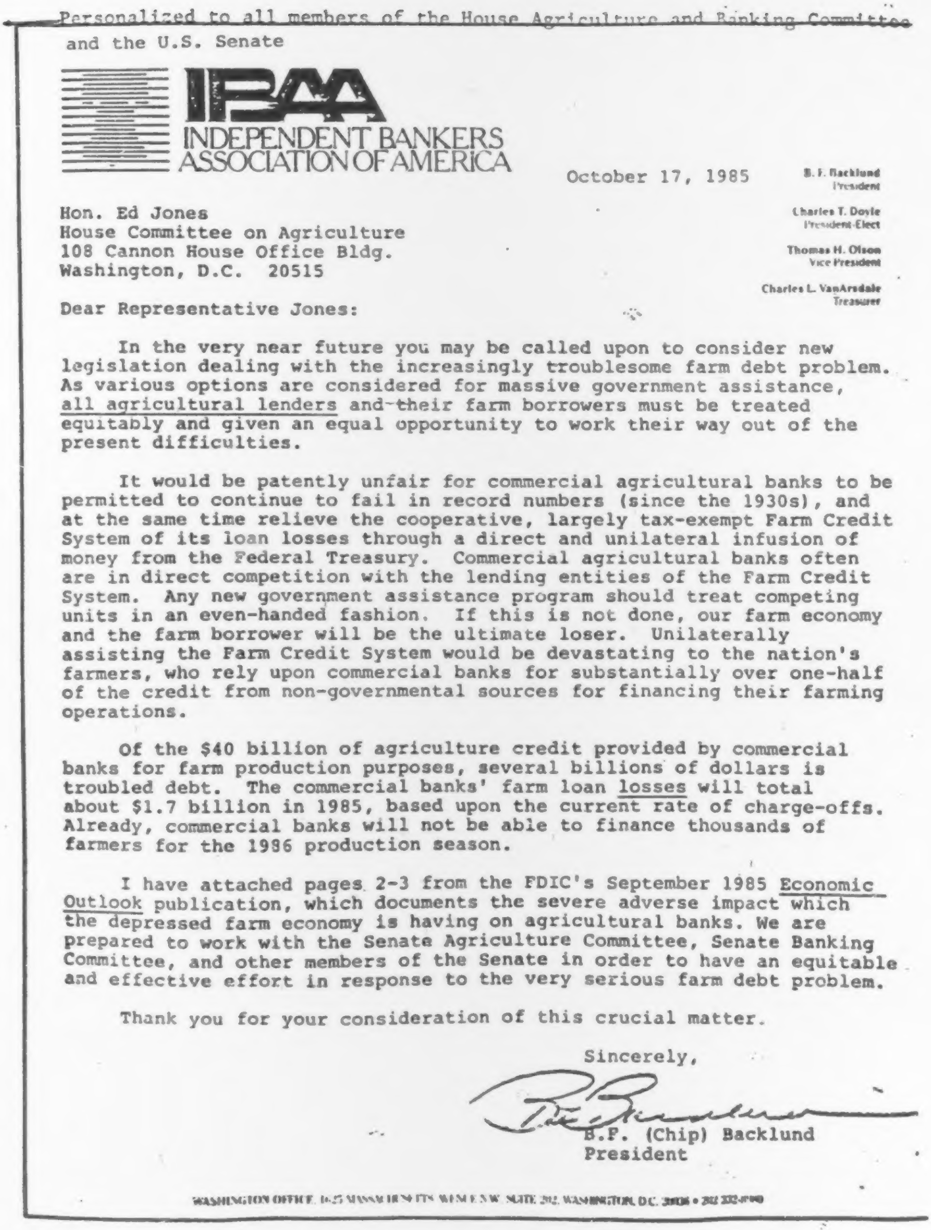
   a) For new financing extended for the current production year for operating expenses, the commercial bank or cooperative lender would be compensated by the corporation for the face value of the unpaid debt.

   b) For the collateralized portion of the farmer's debt, the commercial bank or cooperative lender would be compensated for the appraised value of the collateral securing the loan at the time the loan is purchased.

7. Commercial banks would be permitted to amortize over a multi-year period the loss due to the discounting of loans sold to the corporation.

8. The corporation would pass through the discount to the farm borrower, by reducing the debt owed accordingly.

9. The corporation could contract on a fee-for-service basis with the lender from which the loan was purchased, or another local lender, to service loans which the corporation purchases.



Personalized to all members of the House Agriculture and Banking Committee and the U.S. Senate

IBAA
INDEPENDENT BANKERS
ASSOCIATION OF AMERICA

B. F. Backlund
President

Charles T. Doyle
President-Elect

Thomas H. Olson
Vice President

Charles L. VanArsdale
Treasurer

October 17, 1985

Hon. Ed Jones
House Committee on Agriculture
108 Cannon House Office Bldg.
Washington, D.C. 20515

Dear Representative Jones:

In the very near future you may be called upon to consider new legislation dealing with the increasingly troublesome farm debt problem. As various options are considered for massive government assistance, all agricultural lenders and their farm borrowers must be treated equitably and given an equal opportunity to work their way out of the present difficulties.

It would be patently unfair for commercial agricultural banks to be permitted to continue to fail in record numbers (since the 1930s), and at the same time relieve the cooperative, largely tax-exempt Farm Credit System of its loan losses through a direct and unilateral infusion of money from the Federal Treasury. Commercial agricultural banks often are in direct competition with the lending entities of the Farm Credit System. Any new government assistance program should treat competing units in an even-handed fashion. If this is not done, our farm economy and the farm borrower will be the ultimate loser. Unilaterally assisting the Farm Credit System would be devastating to the nation's farmers, who rely upon commercial banks for substantially over one-half of the credit from non-governmental sources for financing their farming operations.

Of the $40 billion of agriculture credit provided by commercial banks for farm production purposes, several billions of dollars is troubled debt. The commercial banks' farm loan losses will total about $1.7 billion in 1985, based upon the current rate of charge-offs. Already, commercial banks will not be able to finance thousands of farmers for the 1986 production season.

I have attached pages 2-3 from the FDIC's September 1985 Economic Outlook publication, which documents the severe adverse impact which the depressed farm economy is having on agricultural banks. We are prepared to work with the Senate Agriculture Committee, Senate Banking Committee, and other members of the Senate in order to have an equitable and effective effort in response to the very serious farm debt problem.

Thank you for your consideration of this crucial matter.

Sincerely,

B.F. (Chip) Backlund
President

WASHINGTON OFFICE, 1625 MASSACHUSETTS AVENUE N.W., SUITE 202, WASHINGTON, D.C. 20036 • 202 332-8980

STATEMENT OF FRANK SMEAL - GENERAL PARTNER, GOLDMAN, SACHS & COMPANY
BEFORE THE HOUSE AGRICULTURE COMMITTEE
SUBCOMMITTEE ON CREDIT, CONSERVATION AND RURAL DEVELOPMENT

Mr. Chairman:

My name is Frank Smeal. I am a General Partner in charge of the Fixed Income Division and a member of the Management Committee of Goldman, Sachs & Company, an investment banking firm with headquarters in New York City and offices across the United States and abroad. I am pleased and honored to have this opportunity to testify about the market impact of recent reports of financial strains within the agricultural community in general and the securities of the Federal Farm Credit System in particular.

Before I begin my testimony, I feel it is my duty to inform this committee of the activities in which Goldman Sachs engages on a daily basis, both as a trader and an investor, which could influence my remarks and observations. Goldman Sachs is a primary dealer in United States Government and Federal agency securities. We make active and continuous two-way markets in all Treasury and Federal agency securities. In addition, we are a member of the dealer selling groups for new long-term agency issues, whereby we assist in the distribution of these securities to the public. Goldman Sachs is also the only dealer firm which is a member of the selling groups for the short-term discount note programs of all Federal agencies and the World Bank.

On the investment side, Goldman Sachs operates a money market mutual fund known as Institutional Liquid Assets, or ILA, of which I am a Trustee. This money fund has in the past been and is presently an investor in Federal agency securities, including those of the Federal Farm Credit Banks.

Recent reports on the severe financial pressures currently being experienced by the Federal Farm Credit System have had a very definite and discernible impact on the market in Farm Credit securities and, to a lesser extent, on the markets in securities of other Federally-sponsored agencies. This can be clearly seen by examining changes which have taken place in the yield relationships between Farm Credit and other agency securities and U.S. Treasury securities with equivalent maturities. Historically, the yield differences or "spreads" between Treasury and agency securities -- which are typically quoted in "basis points", or hundredths of a percentage point -- have been small, stable, and reasonably predictable. This has been true because the securities of Federal agencies are generally viewed by fixed-income market participants as possessing excellent credit quality because of the "sponsorship" of the United States Government.

Beginning in late July, the yield spreads between Farm Credit and Treasury securities widened beyond their traditional range. This increase in yield spreads, which can be seen in the chart before you, occurred as the Farm Credit System disclosed its intention to assemble a financial aid package for the Omaha Intermediate Credit Bank. Over the next few weeks, as market concerns about the Farm Credit System's financial situation waned these yield spreads gradually narrowed, although they did not return to their previously prevailing levels. On September 4, the Wall Street Journal published a front page article bearing the headline, "Out of Options: Farm Credit System, Buried In Bad Loans, Seeks Big U.S. Bailout". The market in Farm Credit securities, which was still recovering from its earlier difficulties, came under intense new pressure; yield spreads between Farm Credit and Treasury issues soared, going from 16 basis points to 64 basis points for issues with six months to maturity and from 35 to 50 basis points on issues maturing in five years. Since that time yield spreads for Farm Credit securities have gradually though erratically widened further, as periodic news items and investigative articles have served to keep the market's attention focused on the System's problems and the general problems of agriculture. By late last week, Farm Credit issues with maturities of six months, two and one-half years, and five years were all trading at yields more than 100 basis points -- over a full percentage point -- higher than their Treasury counterparts, yield spreads that only a short while ago would have been almost inconceivable.

There are two different, though related, factors which I perceive as being the primary forces behind this dramatic and ongoing widening of yield spreads between Farm Credit and Treasury securities. First, it is undoubtedly true that the steady stream of negative reports on the agricultural economy and the Farm Credit System's finances has caused some market participants to question the credit quality of Farm Credit securities, although I believe this group to be fairly small. A second and perhaps equally or more important force behind the widening of yield spreads is what has been called the "hassle factor" -- many traders and investor groups who do not question the creditworthiness of the Farm Credit System simply wish to avoid the irritations which can arise in dealing with Farm Credit securities under existing circumstances. Risk-averse investor groups such as money market mutual funds and commericial bank trust departments have reduced their participation in the Farm Credit market issues due to fears of market volatility or perhaps a desire to minimize questions about their exposure to Farm Credit System financial difficulties. In a similar way, traders have become more cautious toward Farm Credit instruments as increasingly unpredictable yield spreads and a shrinking investor base have made them less confident of their ability to adequately hedge their positions or to find buyers at what they feel are reasonable prices. This desire on the part of many investors and traders to avoid the uncertainties and headaches which are currently attached to Farm Credit securities has all the characteristics of a vicious cycle: as investors become less willing to own Farm Credit paper, traders react by reducing their trading activities, which results in a loss of liquidity and an additional incentive for investors to scale back their exposure to Farm Credit still further.

The Farm Credit System, through its Funding Corporation, has responded to this deterioration in the market for its securities by lowering its total volume of financing and by shifting its mixture of financing toward short-term securities such as discount notes and away from longer-term issues. As the bar chart illustrates, over the first nine months of 1985 Farm Credit has increased its discount note outstandings by $3.1 billion, while reducing the amount of outstanding 6- and 9-month bonds and term issues by $3.8 billion and $2.5 billion, respectively, so that there has been a net reduction of $3.3 billion in total Farm Credit securities outstanding. This change in Farm Credit's financing patterns has had a beneficial effect in stabilizing the market for its long-term issues; our traders estimate that yield spreads between Farm Credit and Treasury issues with five years to maturity might be 10 to 15 basis points wider than their already-wide levels had the agency not modified its financings in this fashion.

Besides raising borrowing costs for the Farm Credit System and the many farmers it supports, the deterioration in yield spreads between Farm Credit and

Treasury securities has inflicted substantial losses on holders of Farm Credit paper. Goldman Sachs estimates that the market value of outstanding Farm Credit securities has declined by $1 1/4 to $1 1/2 billion since mid-July. It must also be noted that the problems of Farm Credit have spilled over into the markets for securities of other Federal agencies, particularly among issues with long terms to maturity. There has been a roughly 25 basis point increase in yield spreads for long-term issues of the Federal Home Loan Bank and the Federal National Mortgage Association since mid-year, while the yield spreads for discount notes of these agencies have widened by about five basis points.

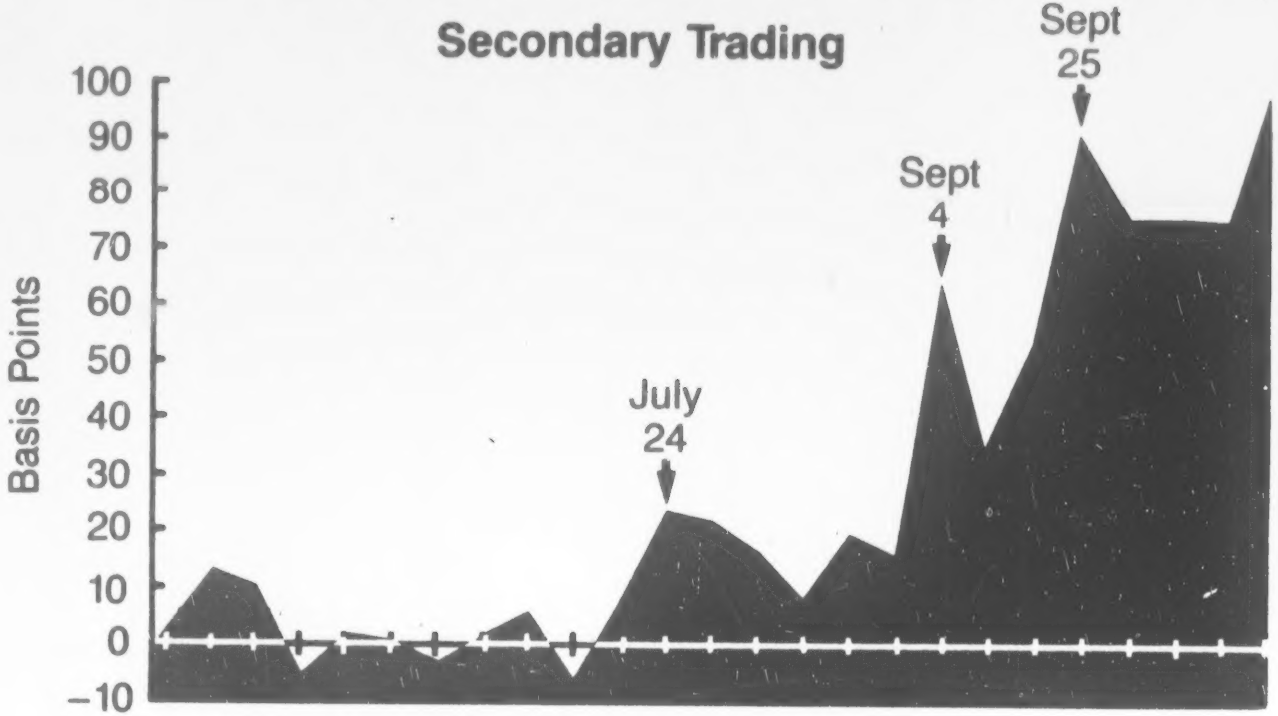
It is neither my desire nor my intention to endorse any of the proposals which have been put forth as to what actions can or should be taken to assist the Farm Credit System, and I do not choose to propose any solution of my own. I would, however, like to strongly emphasize my feeling that from the standpoint of stable and efficient markets for securities of the Farm Credit System and other Federal agencies it is extremely important that any actions which are to be taken occur as soon as possible. Although the yield spreads between Farm Credit and Treasury securities have widened substantially since the System's financial difficulties were widely publicized, I doubt that very many people in the fixed-income markets seriously believe that the Farm Credit System will be permitted to collapse and that holders of Farm Credit securities will not be repaid the full amount of their investments. At the same time, the absence of any strict legal obligation on the part of the Federal Government to assure payment on Farm Credit obligations requires that market participants watch closely for indications that their faith in Federal support for Farm Credit was not justified. It is for this reason that from the market's point of view, no news regarding an aid package for Farm Credit is decidedly not good news. The mere passage of time may give rise to an impression among investors and traders that Federal authorities are either unable or unwilling to respond to the System's request for help. Any deterioration in market confidence can be expected to produce an additional widening of yield spreads that will intensify the pressure on the Farm Credit System and the farmers who depend on its access to low-cost financing. Indeed, in the unlikely event that key Administration or Congressional officials should declare their opposition to Federal financial aid for the Farm Credit System, I believe it is possible that demand for Farm Credit Securities could virtually evaporate, and that yield spreads between other agency securities and Treasuries would widen dramatically, as the market would increasingly question the depth of the Federal Government's commitment to its other sponsored agencies. Beyond my general belief that time is of the essence in resolving the Farm Credit financial crisis, I can identify two upcoming events which I feel could further threaten the integrity of the market in Farm Credit securities should there be no change in the System's financial situation by the time of their occurrence. First, as we approach year-end those who like myself have responsibility for the investment policies of money market mutual funds must address the issue of whether they want to be shown as holding a large percentage of their funds' assets in Farm Credit securities on their annual financial statements. Lacking tangible evidence of strong Federal support for the Farm Credit System, it would be reasonable for these individuals to elect to reduce their holdings of Farm Credit issues, which could touch off another noticeable widening of yield spreads. Second, should we enter the new year without any formal Federal support for Farm Credit the market can be expected to increasingly focus on the timing and possible contents of the first outside audit in the System's history. The uncertainty which surrounds this report could cause market participants to become even more cautious in advance of its release, potentially leading to further defections of investors from the market, an even lower level of trading activity, and still-wider yields spreads between Farm Credit and Treasury securities.

I would be pleased to respond to questions. You should keep in mind that I am here not as an expert on economic conditions in agriculture, but as a spokesman on the market for the securities of the Farm Credit System. Thank you.

(Charts follow:)

Spread Between
6-Month FFCB & T-Bills

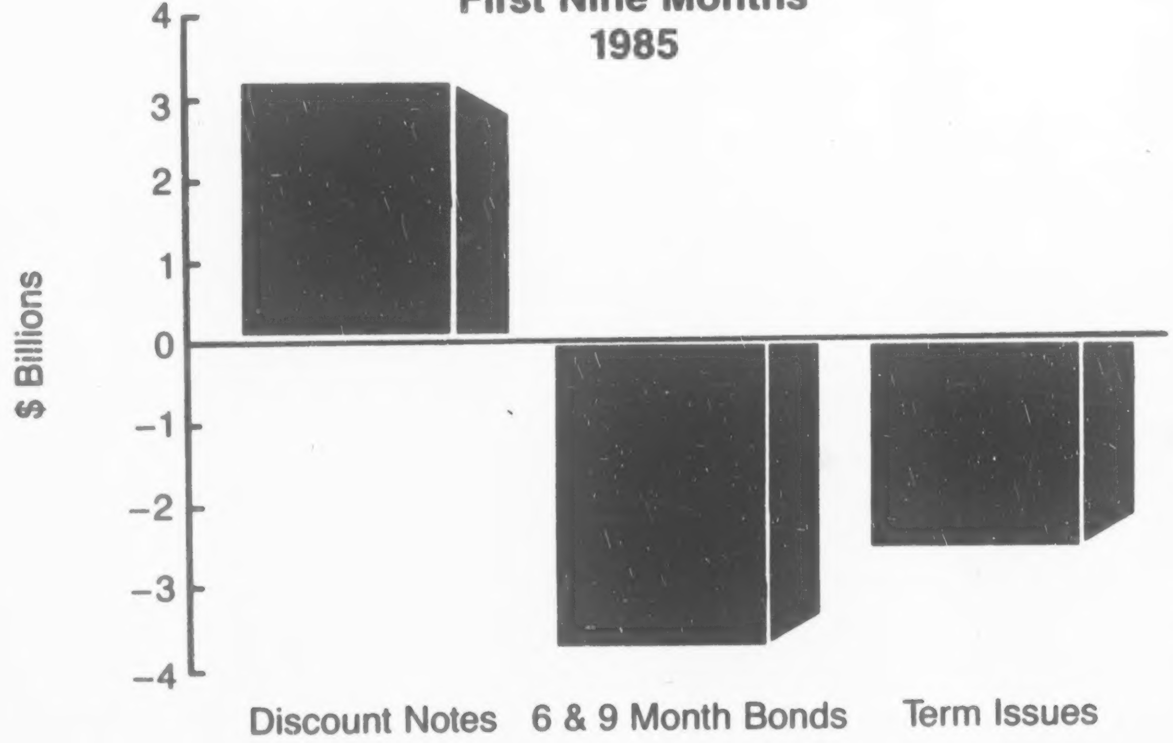
Secondary Trading



Weekly Data: 5/8/85-10/23/85

New Money By Type of Instrument

First Nine Months 1985



TESTIMONY OF KY P. EWING, JR.

on behalf of

GRASSROOTS: THE NATIONAL ASSOCIATION OF FARM CREDIT SYSTEM STOCKHOLDERS

and

THE FEDERAL LAND BANK ASSOCIATIONS OF TEXAS STOCKHOLDERS' DEFENSE FUND

Before the

SUBCOMMITTEE ON CONSERVATION, CREDIT
AND RURAL DEVELOPMENT
of the
HOUSE AGRICULTURE COMMITTEE

October 30, 1985

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TESTIMONY OF KY P. EWING, JR.

on behalf of

GRASSROOTS: THE NATIONAL ASSOCIATION OF
FARM CREDIT SYSTEM STOCKHOLDERS

and

THE FEDERAL LAND BANK ASSOCIATIONS
OF TEXAS STOCKHOLDERS' DEFENSE FUND

My name is Ky P. Ewing, Jr. I am a partner in the law firm of Vinson & Elkins and appear today on behalf of Grassroots: the National Association of Farm Credit System Stockholders ("Grassroots") and on behalf of the Federal Land Bank Associations of Texas Stockholders' Defense Fund ("Defense Fund"). Also present are Mr. Luman Holman, Executive Director of Grassroots, and Mr. Don Neal, Chairman of the Defense Fund. 1/

1/ Mr. Luman Holman is a farmer, banker and lumberman from Jacksonville, Texas, who is on the Board of Directors of the Tyler Federal Land Bank Association (and its former chairman).

Mr. Don Neal is a rancher and former banker from Rochelle, Texas, who is a shareholder in Cattelmen's Production Credit Association, a director of McCulloch County Electric Cooperative, a former Chairman of the Board of The Farmers and Ranchers Cooperative of Brady, Texas, a Director and Chairman of the Brady Federal Land Bank Association, and a Director of the Texas and Southwestern Cattle Raisers Association. Mr. Neal currently serves as Chairman of the Stockholders Advisory Committee of the Federal Land Bank Associations of Texas.

Grassroots was organized by farmer/rancher borrowers of the Farm Credit System and has representation from 10 of the 12 Farm Credit Districts. It is composed of PCA people, Land Bank people and people interested in cooperatives. The Defense Fund represents farmer/rancher borrowers from 42 of the 44 Land Bank Associations in Texas.

The aim of these shareholder organizations is to reflect directly to the Congress and the Administration the views of shareholders of the system. They want to help the system stay alive in today's difficulties and restructure itself to carry out its essential farm credit functions in a more efficient and responsible manner, while preserving the equally essential local control and management of a truly cooperative system.

At the bedrock of shareholder concerns for legislative change are

(1) local control by farmer-rancher borrowers through boards of directors of banks and associations elected by and accountable to each institution's shareholders,

(2) the restructuring of the Farm Credit Administration into a true regulatory agency, with the elimination of its loan promotion and management activities and powers, and

(3) returning the system to its essential banking elements in a way that will restore confidence in the system, both on the part of farmer-rancher borrowers and on the part of the capital markets to which the system must go for its money.

In an attempt to contribute responsibly to debate on needed legislative change, these shareholder groups have met with high officials of the Administration, the Agriculture Department, and the Office of Management and Budget, with high officials of the Farm Credit Administration, with numerous representatives of the 37 banks of the system and the Farm Credit Council, and with other national farmer organizations.

After obtaining as much information as we could on the financial condition of the farm credit system, as well as on the difficulties it faces, and after a thorough review of the structure and mechanisms now in place in the system, the shareholder groups prepared a legislative package that contains what we believe are essential elements of reform. These are essential elements if we are to restore confidence in the system on the part of the shareholder-borrowers and on the part of the capital markets. Additional elements may be needed, but we believe that the ones I will outline in a moment are necessary elements if the Congress is to help the system restructure itself in the best way. The package does not ask for federal assistance from the Treasury or Federal Reserve Banks; in our view, the changes we are proposing are essential preconditions which should be put in place before anyone seriously considers pouring federal tax dollars into the farm credit system.

As we view it, we are dealing with a $75 billion system that will probably sustain several hundred million dollars of operating losses in the aggregate in this calendar year, but that still has a lendable net worth approaching $8 billion, some $5.3 billion of liquid investment securities and cash, and sufficient assets in the aggregate to allow the system to go forward in helping itself through the next several months of difficult times, if they are properly managed and if capital market and borrower confidence in the system can be restored by legislative reform. 2/

2/ See the Financial Statements of the 37 Farm Credit Banks for the period ended September 30, 1985, released on October 23, 1985.

I. Outline of Shareholder Proposals for Legislative Reform

While we believe that the overall condition of world markets and the agricultural economy in general have clearly played a major role in the difficulties now faced by the Farm Credit Banks, we as shareholders also recognize that in the future the system must have

(a) better decisions at the local level,

(b) better and truer regulation of its banking activities at the national level, and

(c) better mechanisms for using the assets and reserves of the system to insure against the illiquidity and impairment of capital at any one institution of the system.

Our legislative proposal directly addresses each of these basic problems. In addition, it gives new tools to the local associations, and to the regulator, to allow them to help more in making the farm credit system's contribution to the overall solution of our agricultural problems.

In brief outline, the shareholders' proposal would make the following legislative changes:

A. Local Level Governance Changes

1. Give each of the 36 banks in the system its own five-member board of directors elected by the shareholders of that bank (leaving the Central Bank for Cooperatives unchanged).

2. Make the district farm credit boards advisory and reduce the number of directors to five: one from each of the three bank boards and two elected directly from the farmer-rancher borrowers.

3. Require use of generally accepted accounting principles (GAAP accounting) by the banks and associations in the system, require certified public accountant audits at least yearly, and require publication of the financial statements of each of the banks and associations.

4. Restore to the banks and associations management responsibility, by returning to them most of the "prior approval powers" now vested in the FCA.

B. Reform At the National Regulatory Level

5. Create a Federal Farm Credit Insurance Corporation ("FFCIC") with a three-member board appointed by the President with the advice and consent of the Senate, which would have

   (a) cease and desist powers against unsafe and unsound agricultural banking practices,

   (b) a fund created by an initial transfer of reserve assets from present system institutions to the FFCIC in exchange for non-voting shares (with a $2.3 billion initial transfer, plus provision for additional assessments if necessary), and

   (c) the responsibility to insure the 37 banks and the existing associations against illiquidity and against impairment of capital, through use of the fund, by means of loans, grants or guarantees to system banks and associations, but with ultimate responsibility to liquidate system institutions (as a Congressionally disfavored last resort) in order to avoid severe impairment of the FFCIC fund.

6. Eliminate non-banking activities from the Farm Credit System, leaving in place the 37 banks, the existing land bank associations and production credit associations and the Federal Farm Credit Banks Funding Corporation.

7. Statutorily prohibit forced merger of associations or banks (while retaining the right of associations voluntarily to propose mergers of like associations).

8. Make the Federal Farm Credit Board advisory, with its chairman to be appointed by the President.

9. Sunset the Farm Credit Administration (having (a) returned much of FCA's "prior approval" involvement in management to the banks and

the associations, and (b) transferred to a new FDIC type regulatory/insurance agency FCA's residual regulatory power).

C. Added Tools to Help Agriculture

10. At the FFCIC level: statutorily permit the FFCIC to lower the capital requirements for system institutions across the board to not less than 1/2 of 1 percent more than the capital requirements applicable to national banks.

11. At the Local Bank and Association Level: Grant authority to the primary lending institutions in the System, as an alternative to foreclosure, to take title to collateral and lease it back to the debtor, or other viable operator, with the value of the collateral to be includable in the statutory collateral requirement for the issuance of bonds, this function to be specially subject to regulation by the FFCIC which may charge differential premiums in connection with risks growing out of this function.

D. Transition Provisions

12. Provide appropriate transition provisions including (a) an effective date for sunset of FCA and creation of FFCIC ninety days after enactment, (b) continuation of FCA regulations for a temporary period of six months or until promulgation of interim or final FFCIC regulations, whichever is earlier, and (c) asset transfers to FFCIC from sunsetted entities.

We have put the concepts just outlined into statutory language and have submitted to the Members of the Committee our proposed changes in bill form. We have also submitted to the Members of the Committee those changes incorporated in the Farm Credit Act of 1971, as amended, with deletions shown as strikeouts and additions shown in italics.

The Shareholders' Legislative Proposal was introduced in the Senate as S. 1790 by Senator Max Baucus of Montana on October 25, 1985.

The remainder of this statement attempts (a) to discuss each of our legislative changes in greater detail, (b) to comment on other basic models for change being suggested to the Congress~~, and (c)~~ to comment on possible federal assistance packages.

II. Discussion of Shareholder Proposal

A. Reform at the Local Level

Our shareholder proposals will keep the present basic structure of the Farm Credit system, with its 37 banks and its existing land bank and production credit associations. Joint bonds would continue to be issued to raise money from the capital market, and local decisions would continue to be made for lending to farmers and ranchers for long-term and short-term agricultural credit needs.

Our changes in the local corporate governance provisions, however, would correct some very basic defects that have contributed to the current financial difficulties of the system. Today Land Bank, FICB, and BC assets are being managed by boards of directors that are not elected by the shareholders who own those assets. For example, for any given Land Bank, its shareholders can elect only 2 out of the 7 people who are responsible for managing the bank's assets as its board of directors. Similarly, production credit associations, which are the primary lenders in that segment of the system, are not now required to have their accounts audited by certified public accountants, have not previous to now been required to use generally accepted accounting principles (GAAP accounting), and are not required to publish their financial statements for the intelligent benefit of their shareholders.

Some have characterized the present situation as being one in which those with power are really responsible to nobody. For many shareholders it is always the amorphous "they" who make the decisions, including the loans, but who cannot be voted out of office. Furthermore, under today's statutory arrangements, the incredible number of "prior approvals" of management activities by FCA means far too much deference being accorded to the views (and indeed the whims) of FCA officials who in the past few years clearly have engaged in too many loan promotion activities.

From 1916, when Congress created the Federal Land Banks, until the 1971 amendments to the Farm Credit Act, local control was the heart and soul of the cooperative Farm Credit system.

The people who are the foundation of the system's strength, the farmer and rancher borrowers whom the system was established to serve, are supposed to have a say in the governance of the system, but today their voices are not being heeded by the so-called "leadership" of the system.

Under the situation that now exists, the group of seven people who comprise each District Board is deemed to constitute three separate boards of directors for the three banks in each district. Two members are selected by the land bank associations, two by the production credit associations, and two by the cooperatives. In addition, the governor of the FCA (supposedly the system institutions' regulator) appoints one member to each district board. The mischief under this arrangement is that the borrower shareholders of a given bank are never represented by more than two-sevenths of the directors of their bank. Under such governance procedures the borrowers are effectively disenfranchised. A majority vote of the board can always be obtained without the participation of anyone who is accountable to the bank's shareholders, regardless of the number of shareholders or the relative stock ownership they represent.

While the approximately 100 people who today inhabit the upper reaches of the system -- the officers and directors of the 37 banks -- continue to give lip service to the idea of local control, they have in fact been moving the system in a different direction. You have only to consider their $5 million "Project 1995" to see where they are going. In the Phase III Report setting out their conclusions, they declared the demise of the cooperative movement and the necessity for a "Central Entity" that would be a super-bank holding company through which all of the $75 billion of assets in the farm credit system's individual institutions would be managed.

Lest anyone be misled into believing that the Phase III Report of Project 1995 is simply star-gazing, let me respectfully point out that the "leaders" of the system have already incorporated the Central Entity, with articles of incorporation and by-laws so written that practically anyone could run a major bank holding company out of that legal set-up. They are now actively seeking a person for the Chief Executive Officer job at a salary of $450,000 to $500,000 annually. Under the already existing articles and by-laws, the 13 directors of that "Central Entity," -- not a single one of them directly elected by any shareholder in the system -- plus that highly paid CEO (perhaps with the help of an in-house general counsel), can at any time vote themselves authority to determine how the system goes to the capital markets for money, how that money is lent to farmers and ranchers, and all details of the personnel actions and compensation levels to be taken by all of the System's institutions -- by what will, in fact if not in their press releases, be merely the subsidiaries of this national super-bank "Central Entity" holding company.

Furthermore, you can also see where the 100 or so "leaders" of the System are headed when you consider their almost frenzied efforts to liquidate associations, with resulting loss of shareholder stock, and to coerce massive mergers of system institutions -- matters that, as you are aware, have caused widespread political unrest. The shareholders believe they have been treated in a most heavy-handed manner.

The shareholders do not believe that Congress ever intended to create, either directly or indirectly, a super, national "Central Entity" agricultural bank. To the contrary, Congress has consistently since 1916 mandated a decentralized, locally controlled system. We are certain that if the confidence of the farmer-rancher borrowers in the stability of the system is to be restored, and if sound and knowledgeable lending decisions are to be obtained in the future, Congress must act to set matters right.

If discipline is to be imposed on the crucial local lending decisions by the institutions in the Farm Credit system -- and we believe as shareholders that greater discipline must be exercised -- then the Congress must make basic corporate governance changes in the statute. If local control is to have meaning for the Farm Credit System rather than being a mere buzzword, accountability of directors to the banks' borrowers must be restored.

We believe that mandated accounting statements, certified public accountant audits, and publication of financial statements are necessary if shareholders are responsibly to exercise local control over the people who lend the system's money. Even more important, shareholders of a given institution must elect all of the directors of that institution. To put the matter colloquially, only when shareholders can in fact "vote the bums out," on the basis of real knowledge of what is going on, is there true corporate democracy and effective discipline.

Our proposals put corporate responsibility and accountability where it belongs and also return to the shareholders that portion of FCA's power that has caused it so disastrously to intervene in loan portfolio management.

B. Reform at the National Level

At the national level, after sending bank management-type powers back to the shareholders, our proposal addresses the fundamental problem, which is that the regulator has not had enough effective tools to work with.

It is seldom that shareholders in private institutions suggest to the Congress that a federal regulator be given greater powers. And indeed the commercial banking world views the current exercises of power by the Controller of the Currency in the regulation of banks to be more officious and more arbitrary than they think appropriate. Nevertheless, the shareholder groups, on whose behalf this statement is made, advocate to the Congress the creation of a Federal Farm Credit Insurance Corporation, similar to the Federal Deposit Insurance Corporation, and propose cease and desist powers that can be directed to each bank in the system, to each association in the system, and to their officials. The cease and desist powers are designed to be used against "unsafe and unsound agricultural banking practices" that would directly affect an institution's financial stability or that would cause a disbursement of funds by the insurance agency. This incorporates the judicial interpretation of similar cease and desist powers in First National Bank of Bellaire v. Comptroller, 697 F.2d 674 (5th Cir. 1983), modified to reflect the fact that we are here dealing with agricultural banks. In short, while we advocate real cease and desist powers, we have tied their use to a reasonable standard to which the courts have given ample content in the commercial banking world.

Again on the model of the FDIC, our proposal would make the FFCIC responsible, to the extent of its fund, for insuring each of the system banks and associations against illiquidity and impairment of capital. It would be responsible for doing this by means of guarantees, loans, grants and the purchase of non-voting securities. It would not be a warehousing organization for non-performing loan portfolios. We think such loans can best be serviced by local people who know local situations.

We have chosen the standard for action by the FFCIC to aid system banks and associations after analysis of the nature of the insolvency-type problems confronting portions of the system. Persons familiar with bankruptcy principles will appreciate that there are two basic types of insolvency: (a) where an institution's liabilities exceed its assets, which by definition produces a negative net worth or capital impairment, and (b) where an institution is unable to meet current obligations when due, which is a liquidity crisis that may or may not also involve the other type of insolvency. By allowing the fund to be used by the FFCIC both to correct or stave off impairment of capital, and also to deal with illiquidity, the FFCIC would be given the flexibility to tailor its response to the particular difficulties being faced by a system institution.

We have also provided, as a "Congressionally disfavored option exercisable only to prevent severe impairment of the insurance fund", that the FFCIC will have the power to place a bank or association in receivership and to liquidate it. Again by analogy to the world of bankruptcy law, only if reorganization is truely impossible would the FFCIC ever have an incentive to liquidate an association rather than to try and let it work out its difficulties. Yet the ultimate discipline of liquidation would be available as a tool that, in extreme cases, could be used by the regulator. The liquidation powers are patterned after those of the FDIC in 12 U.S.C. § 1821(d).

The FFCIC would not have authority to force a merger, but is expressly given authority to review voluntary mergers proposed by associations, and is required to approve such voluntary mergers unless "the Corporation can establish that such merger would result in a non-viable institution within the system or would lessen the long-term financial stability of the System."

We believe that the insurance provisions must be read in conjunction with the cease and desist authority, the removal/suspension authority, and the receivership/liquidation authority. Together they establish a regime under which a system institution's financial difficulty creates full authority in the FFCIC to mandate changes in the practices of the institution and to suspend or remove directors or officers, if necessary, while at the same time making mandatory on the FFCIC that it use the insurance fund to correct the difficulty. We intend, in all but the most extreme cases, that the FFCIC be required to reform a troubled system institution while retaining it as a system entity to serve its geographical territory.

With this combination of responsibility and power in a new FFCIC, we believe that the strongest of the system's borrowers will have less reason to leave the system than they do now, under the present fear of increasingly widespread liquidation of system institutions. Similarly, we believe, once the capital markets realize that the best borrowers in the system have been given incentives to stay, while a new regulatory agency has also been given power to deal in a direct manner with difficulties, that the capital markets will also be reassured.

As to the fund of the FFCIC, we have given it the power to charge premiums based on the loan portfolio volume of each system institution. In addition, as an initial means of large-scale funding, we have provided for a Congressionally mandated transfer of liquid assets from each system institution, as a percentage of each prime lender's loan portfolio. Depending upon what Congress determines to be the appropriate funding level, shareholder groups would favor an immediate transfer of 3 percent (which would produce $ 2.3 billion). It is our understanding that (a) from an accounting perspective the system institutions have reserve accounts exceeding these amounts in the aggregate, so that a transfer of this general magnitude could be made, with non-voting shares of the FFCIC to be held as assets in place of the reserves, and (b) from the liquidity viewpoint, there will be adequate funds to make such a transfer. As of September 30, 1985, according to the Financial Statements of the 37 banks released October 23, 1985, there were $5.5 billion in "investment securities and cash." If any given system bank or association would have difficulty making its initial payment, adjustments or deferred obligations could be authorized.

Overall, our proposed FFCIC would have a fund-to-loan portfolio ratio of 3.0%. By comparison, the FDIC at the end of calendar 1984 had a fund-to-insured deposits ratio of 1.23% ($17.2 billion fund to insured deposits of $1.4 trillion).

The aim here with the proposed FFCIC is to Congressionally mandate that the farm credit system first use its own reserves in an efficient and responsible manner to buttress its own institutions.

In our effort to demonstrate both to the farmer-rancher shareholders who are the borrowers in this system, and also to the capital markets, that the system is effectively dealing with its problems, we have also proposed that the system get back to basics and eliminate all of its non-banking activities. We do this by redefining the elements of the system to be the 37 banks, the existing associations, and the Federal Farm Credit Banks Funding Corporation. We eliminate and liquidate all the other service corporations, transferring any net assets they may have to the FFCIC to augment the insurance fund. The proliferation in recent years of corporate entities, ostensibly providing one kind of service or another to system institutions (rather than having those institutions rely on the competitive market to supply these services) may well have siphoned real dollars out of the system. In any event, the proliferation of these corporations has recently confused people and undermined the credibility of the essential parts of the Farm Credit system. As part of our overall reform, we eliminate these various service corporations.

Also as part of the reform at the national level, we make the Federal Farm Credit Board advisory only, with its chairman to be appointed by the President.

Having returned much of the Farm Credit Administration's "prior approval" authority back to the banks, and having transferred its regulatory power to the Federal Farm Credit Insurance Corporation, we propose the sunset of the Farm Credit Administration.

C. Additional Tools

We propose two additional tools to aid the system in meeting the present agricultural crisis.

First, the FFCIC would be given the power temporarily to reduce the statutory capitalization requirement of system banks, now set in the Act at 10 percent, to a level not less than 1/2 of 1 percent more than the capitalization requirement fixed for national banks. Today, national banks have a capitalization requirement of 5.5 percent (ratio of primary capital to total assets). While this authority, if used, would tend to create more leverage in the system, we believe that, as part of a package of reform, it is not unwise to give added flexibility to the regulator/insurer to deal with the current situation.

Second, the leaseback authority which the shareholder proposal would give to the primary lenders in the system -- the PCAs in that portion of the system and the Land Banks in the other portion of the system -- would attempt to address a more fundamental problem. At present, land values are falling through out most of the country, in some states quite precipitously to levels less than 50 percent of what they were just a few years ago. This reflects the fact that there is an oversupply of land reaching the market: too much land is chasing too few buyers. At present, when a borrower defaults to a farm credit system institution, there is normally a foreclosure and sale of the collateralized land or farm machinery. If even a portion of the land or farm collateral that would otherwise thus be forced onto the already super-saturated market could be held off the market, it would assist the situation, provided the mechanism for doing so is not merely a band-aid that prolongs an intolerable situation.

To the extent that the farm credit system's institutions have lent money on farming operations that are not, and cannot be made, viable at today's commodity prices, it will be better for the system to take its lumps on defaulting loans, to foreclose and to put that collateral on the market to bring whatever can be received for it. But there are also many farming operations, on which system institutions have lent money and where the borrower is in default, that can viably be continued at today's commodity prices -- in short, there is land and there are farmers that will produce future streams of income at current commodity prices sufficient to service the debt needed for the farm operations.

If this land and other collateral could be kept off the market, and the original farmer-borrower or other new viable operator could be kept on the land, we would have solved an important portion of the problem. The key is to make certain that the decisions are made locally about what farming operations are viable. We believe that the proven achievements of the local Production Credit Associations and the Land Banks (through the Land Bank Associations) make them the logical choices, and by far the least costly choices, as the agencies to make these decisions in the current agricultural crisis.

The shareholder proposal would place on the local associations (in a reformed world in which the directors of the banks could be voted out by their own shareholders and in which they must operate with published financial reports using generally accepted accounting standards) responsibility for making the hard choices, in default situations of

(a) whether the land could produce streams of income at current commodity prices sufficient to service the debt, and (b) whether the debtor or some other viable operator should be selected to whom the farm could be leased back. If the land is leased by the original debtor, the shareholder proposal would give the debtor the right of first refusal to repurchase the land or other collateral from the system institution at a price to be determined and negotiated between them in the future. If the leaseback is to other than the original debtor, no such right of first refusal would be involved.

The proposal contemplates that the system institutions could book as an asset the land or other collateral at its current appraised value, thus reflecting in its accounts the difference between the original loan asset and the current "deflated" appraised value. This will nevertheless allow the system institutions to portray a truer financial picture to the capital markets, and a better one than is likely to be the case with forced sales of defaulted collateral.

We realize that others have proposed a central national warehousing authority to purchase the doubtful loan assets in the portfolios of system institutions. We doubt that such a national corporation is the answer, and we are certain that a statutory arrangement in which decisions about land and farmers are made locally is preferable.

The bill provides that the FFCIC may make special regulatory rules about leaseback assets and may charge higher premiums to reflect the risks inherent in these assets versus the risks inherent in performing-loan assets. The fact that higher premiums will be charged to system institutions for leaseback assets in the portfolio will itself be a form of discipline on the local decisions as to when and under what terms to take title and lease back farm land and other collateral.

We are under no illusion that these leaseback provisions will be a panacea. But if perhaps two-thirds of the land that would otherwise be forced on the market through the system's foreclosure and sale requirements could be kept off the market, and farmers kept on the land, a significant contribution would have been made. Furthermore, if it can be accomplished with local decisions, and be based on a realistic view of what the land can produce at current commodity prices, the provision is well worth enacting as an additional tool for use by the Farm Credit System.

III. Comments on Other Models For Change

There seems to be widespread consensus that, in the current agricultural crisis, legislative changes must be made to the Farm Credit Act of 1971.

From discussions around town, it seems perfectly clear that the Congress will be presented a spectrum of possible changes.

A. The Central Regulator Model

There will be the "central regulator model" in which you will be asked to throw additional power to the Farm Credit Administration without really making any other structural changes in the way things operate. It is our belief that simply throwing greater power to the Farm Credit Administration will not adequately reassure the capital markets. We can guarantee you that it will not reassure the farmer-rancher borrowers of the system.

B. The Central Entity Bank Holding Company Model

A second basic model is the "Central Entity Bank Holding Company" model. Under this one, the farm credit system would become more like a national bank holding company operating through subsidiaries in 50 states, that would be very lightly regulated, that would be able to merge and liquidate associations across the country at will, that would probably freely obtain Treasury money, and that would be less rather than more accountable to shareholders.

Even if this model were somewhat appealing to the capital markets, which we doubt, it will not restore the confidence of the shareholder-borrowers in the long-term viability of the farm credit system. This model moves away from local control in any meaningful sense of the term and leaves unsettled the political unrest that already permeates the system's borrowers throughout the country.

C.. The "Open Spigot" of the Treasury

The third model is basically one that would simply let the existing system plug into the Treasury and get the full faith and credit of the United States to back the system's bonds. While we will comment on federal assistance packages in a moment, suffice it to say here that the shareholders on whose behalf this statement is made oppose opening the Treasury to the farm credit system until basic structural reform of the farm credit system has been enacted.

IV. Comment on Federal Assistance

The shareholder groups believe that the farm credit system continues to have sufficient assets to make a significant contribution toward meeting the system's obligations, if the assets are prudently managed and if Congress enacts the structural changes proposed by the shareholders.

We believe that federal money should not be provided to the farm credit system until the system has demonstrated that it is using its own assets to meet its obligations and until structural changes have been made by Congress to allow federal money to be prudently employed.

We note that our proposed FFCIC would be a prudent and effective instrument through which Treasury assistance could be provided most efficiently, by guaranteeing the FFCIC obligations, by loans to its insurance fund, or by grants through it, if federal assistance should ultimately prove necessary because of a worsening world agricultural situation or otherwise.

Conclusion

For the reasons given, we respectfully urge that the Congress give serious consideration to the essential reform elements contained in this shareholder proposal, recognizing that if this country is to continue to have a farmer-rancher owned farm credit system that has the confidence of the capital markets and of its intended farmer-rancher borrowers, shareholder control and accountability for the system must be strengthened.

Thank you.

(Attachments are held in the committee files.)

STATEMENT OF GLENN BELLAMY, SENIOR VICE PRESIDENT, AMERIBANC, INC.

MR. CHAIRMAN, AND MEMBERS OF THE SUBCOMMITTEE, I AM GLENN BELLAMY, SENIOR VICE PRESIDENT OF AMERIBANC, INC.

AMERIBANC, INC. IS A 20 BANK HOLDING COMPANY IN ST. JOSEPH, MISSOURI. FIFTEEN (15) OF THESE 20 BANKS HAVE SUBSTANTIAL INVOLVEMENT IN AGRICULTURAL LENDING.

MY PERSONAL BELIEF IS THAT AMERICAN AGRICULTURE, ESPECIALLY IN THE MIDWEST, IS ON THE EDGE OF A MAJOR FINANCIAL COLLAPSE THAT COULD EFFECTIVELY DESTROY MUCH OF THE MIDWESTERN RURAL AMERICA AS WE KNOW IT, NOT ONLY THE FARMERS, BUT ALSO THE SMALL RURAL COMMUNITIES. THE FARM CREDIT SITUATION IS SO BAD NOW, THAT UNLESS SOMETHING SIGNIFICANT IS DONE IN THE NEAR FUTURE, UP TO ONE-THIRD OF THE COMMERCIAL FARM OPERATORS WILL BE UNABLE TO CONTINUE.

AGRICULTURE PRICES ARE DOWN APPROXIMATELY 25% IN ALMOST EVERY SEGMENT OF AGRICULTURE COMPARED TO A YEAR AGO. AGRICULTURAL BANKS ARE GOING TO FIND IT VERY DIFFICULT TO EXTEND NEW FINANCING TO FARM BORROWERS. UNLESS SOME METHOD CAN BE WORKED OUT TO DEAL WITH THE NON-PERFORMING ASSETS ON THE LENDERS BALANCE SHEETS AND TO HANDLE THE OTHER-REAL-ESTATE, WHICH IS THE REAL ESTATE THAT BANKS HAVE ACCUMULATED EITHER BY FORECLOSURE OR VOLUNTEER CONVEYANCE BY THE BORROWER, THE DIFFICULTY OF FINANCING FARMERS WILL BE MUCH MORE SEVERE IN THE SPRING OF 1986.

AS WE DISCUSS THIS, AND THE PROBLEM RECEIVES MORE PUBLICITY, THIS WILL CAUSE MORE ADVERSE REACTIONS BY DISCOURAGING INVESTORS AND FINANCIAL INSTITUTIONS FROM PLACING FUNDS INTO FARMING. AS A RESULT, FARMLAND PRICES WILL ALMOST CERTAINLY DROP EVEN LOWER THAN THEY WOULD HAVE WITHOUT THE ADVERSE PUBLICITY.

THE LOSSES RECOGNIZED IN AGRICULTURE TODAY IS ONLY A PART OF THE TOTAL LOSSES SIMPLY BECAUSE WHEN A LENDER FORECLOSES THEY HAVE TO FIND SOMEONE TO BUY OR LEASE THE LAND, OR MANAGE IT THEMSELVES. TO SELL THE LAND IS ALMOST IMPOSSIBLE, THEREFORE, THE FARMHOUSE STANDS EMPTY, OUTBUILDINGS DETERIORATE AND THE VALUE OF THE FARM DROPS FURTHER; MOST OF THE TOWNS IN THE RURAL MIDWEST ARE NOW DISCOVERING THEY CANNOT RELY ON AGRICULTURE AS AN ECONOMIC BASE THE WAY THEY ONCE DID. THIS SITUATION WILL PROBABLY WORSEN. AGRICULTURE, IN MUCH OF THIS AREA, WILL FIND IT HARD TO COMPETE, AND THEIR CONTINUED PROBLEMS WILL REFLECT ON THE COMMUNITIES. THESE COMMUNITIES ARE UNDER MAJOR PRESSURE.

I WOULD PROPOSE THAT THE FOLLOWING SOLUTIONS BE CONSIDERED: FIRST, COMMODITY PRICES AND INCOME SUPPORTS IN THE FARM BILL ARE VERY IMPORTANT TO KEEP THE FARMERS FINANCIAL SITUATION FROM DETERIORATING FURTHER. THE FARMER MUST HAVE ADEQUATE RETURNS FROM AGRICULTURE TO SERVICE HIS DEBT AND TO PREVENT THEM FROM SLIDING INTO INSOLVENCY. IF COMMODITY PRICES CANNOT BE STABILIZED, THEN WE SHOULD REDUCE THEM OVER A PERIOD OF TIME, SUCH AS FIVE YEARS. CERTAINLY A LAND RETIREMENT PROGRAM

WOULD BE BENEFICIAL FROM THE STANDPOINT OF LOWERING PRODUCTION AND THUS IMPROVING PRICES AND WOULD ALSO ALLOW US TO TAKE CARE OF A HUGE LAND EROSION PROBLEM. ANY PROGRAM THAT IMPROVES PRICES AND FARM INCOME WILL ULTIMATELY BENEFIT LENDERS AND MAY BE LESS COSTLY IN THE LONG TERM.

SECONDLY, THAT AN ASSISTANCE PACKAGE OF GOVERNMENT GUARANTEES OF PROBLEM LOANS BE CONSIDERED. THIS COULD BE TIED TO THE EXISTING PROGRAM WITHIN FARMERS HOME ADMINISTRATION. I WOULD PROPOSE THAT THIS BE A PHASE DOWN PROGRAM WHERE YOU START WITH A 90% GUARANTEE IN YEAR ONE (1) AND DROP THE GUARANTEE 10% A YEAR. WHILE THAT WOULD NOT CURE ALL THE PROBLEMS, IT WOULD ALLOW FARMERS AND LENDERS TO DEAL WITH THEIR PROBLEMS IN AN ORDERLY FASHION OVER A PERIOD OF TIME.

THIRDLY, EARLY IN 1985, THE FARM CREDIT SYSTEM PROPOSED AN AGRICULTURAL CONSERVATION CORPORATION, WHICH WOULD HAVE THE AUTHORITY TO PURCHASE FARMLAND AND "WAREHOUSE" THAT LAND FOR A PERIOD OF TIME. THIS WOULD ALLOW MARKETS THAT ARE COMPLETELY SATURATED TO RECOVER. FARMLAND WOULD BE SUBJECT TO PURCHASE ONLY WHEN IT WAS ALREADY HELD IN INVENTORY BY A LENDER.

EACH OF THESE MEASURES, THE GUARANTEED LOANS, WAREHOUSING OF LAND, AND OTHERS, SHOULD BE EQUALLY ACCESSIBLE TO FARM CREDIT BANKS AND THEIR BORROWERS, AND TO COMMERCIAL AGRICULTURAL BANKS AND THEIR BORROWERS. IT IS VERY IMPORTANT THAT AN EQUITABLE SITUATION BE MAINTAINED AMONG LENDERS AND FARM BORROWERS AS DEEPER LEVELS OF FEDERAL ASSISTANCE ARE BEING CONSIDERED. TO

ALLOW ANY SORT OF UNEQUAL ACCESS TO ANY FORM OF ASSISTANCE BETWEEN COMMERCIAL BANKS AND THE FARM CREDIT SYSTEM, WOULD SIMPLY FORCE SOME SMALL COMMERCIAL BANKS OUT OF BUSINESS WHICH WOULD BE THE END OF MANY SMALL MIDWESTERN COMMUNITIES.

IT ISN'T THAT I WANT A PROGRAM THAT REDUCES BANK LOSSES, BUT A PROGRAM THAT RESULTS IN A GRADUAL WORK DOWN OF THE PROBLEM. BANK REGULATIONS AND SUPERVISORY EXAMINATION POSITIONS, ALTHOUGH SOUND FROM A NORMAL FINANCIAL VIEWPOINT, JUST MAKE IT IMPOSSIBLE FOR MANY BANKS TO SURVIVE. THE LOSS OF A FARM BANK JUST PUTS A NAIL IN THE COFFIN OF THE FARM COMMUNITIES. MY SUGGESTION OF THE GUARANTEE PHASE DOWN WOULD LET MANY BANKS SURVIVE.

IN SUMMARY, I BELIEVE THAT PRICE AND INCOME SUPPORTS, LOAN GUARANTEES, WHICH ALLOW US TO BRIDGE OURSELVES TO THE ULTIMATE RESOLUTION OF THIS AGRICULTURAL PROBLEM, WILL BE THE BEST WAY TO ASSIST FINANCIALLY-STRESSED FARMERS AND INDIRECTLY TO BENEFIT LENDERS.

WHATEVER THE ULTIMATE SOLUTION MIGHT BE, I WOULD STRESS THE NEED FOR A SYSTEM WHICH IS EQUALLY ACCESSIBLE BETWEEN THE FARM CREDIT SYSTEM, THE BANKS, AND THEIR FARM BORROWERS. COMMERCIAL AGRICULTURAL BANKS HAVE BEEN AND WILL BE ESSENTIAL TO MEET THE OPERATING NEEDS OF FARMERS AND THE FARM ECONOMY IN THE SPRING OF 1986 AND THEREAFTER. I WOULD ENCOURAGE THAT WE KEEP THE AGRICULTURAL BANKS IN A FULLY COMPETITIVE AND VIABLE POSITION IN ORDER TO MEET THESE NEEDS.

STATEMENT OF
ROY A. SEABERG, JR.
CHAIRMAN OF THE BOARD
FARM CREDIT BANKS OF TEXAS
BEFORE THE
HOUSE AGRICULTURE SUBCOMMITTEE
ON
CREDIT, CONSERVATION AND RURAL DEVELOPMENT

Mr. Chairman:

My name is Roy A. Seaberg, Chairman of the Board of Directors of the Farm Credit Banks of Texas and a rice farmer from Huffman, Texas.

I have been chairman of the Texas Farm Credit Board for two years and a member of the board for almost six years. I have been a rice farmer all of my adult life, except for the years spent in completing educational requirements.

Today, I address this subcommittee as chairman of the Texas Farm Credit Board and as a farmer and a stockholder of both a Federal Land Bank Association and a Production Credit Association. The message I have to share with you is fourfold.

First, to share with you Texas' concern for the financial plight of farmers of this Great Nation and add our whole-hearted support for the request for government assistance for the Farm Credit System.

Second, to bring you the perspective of a presently healthy Farm Credit District that yet has not suffered the severe problems and the severe losses of some of our sister Farm Credit organizations.

Third, to ask you not to require that we exhaust Farm Credit resources before providing government assistance.

And, fourth, to suggest an alternative concept of financial assistance that would not affect adversely the now healthy Farm Credit districts.

The common thread running throughout my message today is to ask Congress, as it considers an assistance plan for the Farm Credit System, to focus on a solution that is truly in the best interest of the farmer and rancher.

Some members of Congress and representatives of the Administration have indicated a willingness to provide financial assistance for the Farm Credit System, only after all of the Farm Credit System's resources, all of its capital surpluses, are exhausted. While we do not know what the financial assistance package will look like, we do know that such a requirement places the financial position of farmers in even more jeopardy.

We have heard today about the serious and extreme losses farmers are experiencing around this nation. As a board member of the Farm Credit System, I have always contended that the institution, the Farm Credit System, is secondary to the individual, the farmer and rancher. We believe that to ask the Farm Credit System to contribute all of its available financial resources before government provides assistance focuses our concern on the institution, the Farm Credit System, and disregards the farmer and rancher.

It is clearly the intent of Congress, as stated in Section 1.1 of the Farm Credit Act of 1971, as amended:

"...that the farmer-owned cooperative Farm Credit System be designed to accomplish the objective of improving the income and well-being of American farmers and ranchers by furnishing sound, adequate, and constructive credit..."

Congress properly intended that the Farm Credit System exist to serve farmers and ranchers beneficially. If the System cannot do that, it no longer has a reason to exist.

The focus of any assistance plan must be on the needs of farmers and ranchers--farmers and ranchers who have exhausted much of their personal resources and are watching their equities in the Farm Credit System rapidly erode. The exorbitant interest rates paid by farmers and ranchers these past several years have added billions of dollars to their operating costs and contributed materially to today's financial disaster. Artificially high rates, conciously induced by agencies and instrumentalities of government through some grand experiment in marcoeconomic management, are the principal cause of the burgeoning surplus of agricultural commodities and the resulting present low prices.

It is a fact that we farmers are not producing more today, we are simply selling less because of dollars overpriced by high interest rates in the United States.

The capital surplus of the Farm Credit System, just as in any financial institution, is a major component of interest rates paid by borrowers. To further exhaust these surpluses, thereby adding to the already high interest rates paid by the farmers and ranchers we serve, seems to us an irrational exercise in futility, contributing even more to the financial problem of Farm Credit farmers and, ultimately, to the financial problems of all farmers and ranchers.

Interest rates today in the Texas Farm Credit District are among the lowest in the Farm Credit System. But, they are too high. Even some of our farmers are paying an effective rate of more than 14 percent. This represents a real interest rate that exceeds the real rate of interest of a few short years ago when the prime rate was 21 percent. And, farmers and ranchers of other Farm Credit Districts are suffering from even higher interest rates. We believe the Farm Credit System has exhausted all of the resources we can without creating even more problems for the very people we are trying to help--the farmers.

The Texas Farm Credit District is healthy today. Loan losses for our Texas District this year are projected at between six and seven million dollars -- small when measured against our loans outstanding of more than four billion dollars.

The Texas Farm Credit District is proud of its record. We believe we can remain healthy:

If, the agricultural economy materially improves.

If, we in Texas are not required to give up our reserves.

However, our projections for agriculture in Texas are similar to those you have heard and will hear today. Declines in land values are taking their toll, particularly in the High Plains area around Lubbock.

Many of our farmers who have hung-on these past several years have done so because of some visionary juggling. If cotton prices looked good, they planted cotton. The next year, if milo promised more, they planted milo. And, so on.

The juggling has about come to an end. The seemingly endless search for profit has exhausted even many of our best farmers. USDA figures and our own calculations indicate that U.S. farmers are worn; their management abilities have been tested severely; many of their equities are gone. Texas cannot be far behind. We live with the same commodity prices and continued lack of profit as the rest of the nation.

There is still time to help farmers and ranchers who are still viable. I do believe that our nation's farmers have withstood all that they and their management abilities can tolerate. Surpluses, low prices, the cheap food policy, the high value of the dollar, high interest rates--all are uncontrollable from the farmer's perspective. All have worked against him.

We think that the farmers and ranchers have done their part. We think that the Farm Credit System had done its part. Now is the time for government to do its part.

The Texas District offers for you another concept. Establish an amount of aid for the Farm Credit System, based on what you have heard here today, that represents the needs of the System, and fund it as needed. Based on established criteria, banks could apply for help as help is needed. Government equity capital would be infused into requesting banks through approval of a designated government entity, such as USDA or Treasury. The capital would be retired based on prearranged, individual terms. Such a plan would help troubled farmers and troubled Banks without creating problems in untroubled Banks.

We anticipate the amounts to be requested would be small based on Farm Credit System District pride. The time of take down and payback would be stretched out and, therefore, the peak amount outstanding would be less than a single, concurrent investment in the Banks.

We Texans have always lived in a risky environment where tornadoes, hurricanes, drought, hail, floods and pests were prevalent. Some or many of these come to Texas every year. They came this year. They will come next year. A major drought or a mean hurricane can devastate our state. In the past, we have weathered the storm. We believe we can probably weather it again, but only if we are allowed to remain viable.

The Texas District is an inextricable part of the Farm Credit System. We have willingly come to the aid of two of our sister banks. We accept our responsibility to support the Farm Credit System as we ask for financial assistance. While not asking for help for ourselves, we know that many of our sister Banks are in serious financial condition and their survival without government help is doubtful.

The Texas Farm Credit Board feels as if Texas farmers and their Farm Credit district have met the test imposed by the recent agricultural environment.

That is:

To be prudent. To tighten our belts. To operate in a risky environment. To keep our loan portfolios in good shape. To make wise decisions. To manage our business well. To be selective in the use of innovations in a deregulated financial industry.

We know, too, that if farm income does not materially improve, despite the best efforts of Texas farmers and ranchers and their Texas District Banks, severe financial stress will overtake our District as well.

We believe a healthy, vibrant agricultural economy is essential to the long term economic security of this nation. We believe also that a healthy, vibrant farmer-owned cooperative provider of credit is essential to a healthy agricultural industry.

Thank you, Mr. Chairman.

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TESTIMONY ON BEHALF OF FIRST SOUTH PRODUCTION CREDIT ASSOCIATION
JACKSON, MISSISSIPPI

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10/28/85
PKP

TESTIMONY ON BEHALF OF FIRST SOUTH PRODUCTION CREDIT ASSOCIATION

P. O. Box 16627
Jackson, Mississippi 39236-6627
(601) 957-4442

Robert A. Carson
Cotton & Soybean Farmer
PCA Board Chairman
Lambert, Mississippi

James Henry Gilfoil, III
Cotton & Grain Farmer
PCA Board Member
Lake Providence, Louisiana

IDENTIFICATION

1. We represent the 21-member board of directors of the recently formed First South Production Credit Association.

2. Our association is in the Fifth Farm Credit District, which covers Alabama, Mississippi and Louisiana. First South PCA was formed through the merger of 16 PCAs in the three-state area. The headquarters office is in Jackson, MS.

3. We appreciate having this opportunity to tell you about how and why our merger took place and about what conditions are like in our district today.

4. We have provided you with a small package of material describing the rationale for our recent merger and some of the positive results that have taken place since that time.

WHAT IS THE MAJOR PROBLEM IN AGRICULTURE TODAY?

5. The major problem in agriculture today is a LACK OF PROFITABILITY. Until profitability is restored to the American farmer, we will continue to suffer under extremely critical economic conditions.

6. The gap between total farm debt and net farm income has continued to grow wider over the past decade. Land values continue to drop because of the lack of profitability in farming. And because of rising debts and falling land values, the equity for the typical American farmer is now being squeezed out.

7. The vicious cycle of falling income levels and dwindling farmer equity has caused Farm Credit lenders, such as production credit associations, to be subjected to unusually stressful business and financial conditions.

WHAT ARE PCAs DOING ABOUT THE PROBLEM?

8. Nevertheless, PCAs have gone the extra mile with their member/borrowers. The result in our own district has been that PCAs have suffered loan losses amounting to over $60 million over the past three years. In so doing, our PCA has lost virtually all of its retained earnings and reserve for bad debts that had been generated over its 52 years of existance. We no longer have retained risk funds, and we are now dependent upon our equity in the FICB of Jackson to pull us through these stressful economic conditions in agriculture.

9. These losses have had a devastating effect on some PCAs. In our recent history, we had 26 associations. As PCAs started encountering difficulty, however, they started merging with their neighboring associations to gain more stability and financial strength in their operations.

10. Several months ago, a task force of PCA directors in our district was formed to find a solution. First we thought about merging by state. Then it became obvious that the only real solution was to merge into an association that would cross state lines and would include all three states.

11. When the district-wide merger first came up as a possible strategy for dealing with our problems, we didn't like the idea. It appeared at that time that a merger would mean giving up control by local farmers.

12. But soon it became obvious that this merger was the only reasonable approach for us to accomplish our two main objectives:

    o First, we wanted to achieve much greater efficiency and effectiveness in our business by consolidating our capital and human resources.

    o Second, we wanted to maintain local, grass-roots support and direction for our loan servicing operations.

13. Finally, this past summer the merger took place when 16 associations in our district voted to merge their capital and human resources into one large association that came to be known as First South PCA.

14. This was not an easy decision. It took courage. The directors who formulated the idea had to discuss the issues. We disagreed on many points. Sometimes our decisions meant giving up personal political and emotional desires. But in the end we were able to reconcile our ideas with what we knew would be in the best interests of farmers throughout our 3-state area. When the merger proposition was presented to the membership for consideration, 92 percent of those voting favored the merger.

15. Let me state emphatically at this point that the decision to merge was made strictly by directors and other farmer/members of the district PCAs. The function of management throughout this whole process was to furnish education, information, and leadership to the directors. At no time in the process was there a threat of management interference. If there had been interference from management, the merger process would have failed. The merger of 16 Fifth District PCAs into one PCA represented the ultimate form of "grass roots control" which could be exercised at the district level to solve our own problems.

WHAT DID WE ACHIEVE?

16. Thus far, it appears we have exceeded our greatest expectations for our newly formed association. On the day the merger officially went into effect, interest rates dropped immediately to 10.7 percent. For some of the merging associations, this meant an instant drop in rates of over 2 percent. We have provided you with a list of the interest rates for all the merging associations. This list shows a comparison of rates both before and after the merger.

17. This drop in interest rates came about primarily for three reasons. First, there was a drop in our cost of funds from the FICB. Secondly, because we were able to consolidate the control of the Fifth District FICB and PCA capital under one chief executive officer, we had a reduced need to continue increasing our cash reserves. And thirdly, there was a reduction in our operating budget as a result of greater efficiency within the newly formed PCA. This decline in operating expenses came about primarily through staff reductions in both the FICB and the PCA. (See Attachment on Accomplishments and Objectives.)

18. I remind you that our first objective in merging our PCAs was to achieve greater efficiency and effectiveness. At this time, we are well on our way to accomplishing this objective.

19. Now, remember that our second objective was to maintain grass roots support, direction and control. We have come to realize that since the merger took place, we now have far more control than we ever had before. Instead of directing the operations of our individual territories in each of our respective corners of the district, we now provide direction and control for the three-state PCA, and we have been able to maintain grass roots involvement. Other than a drop in interest rates, our membership has noticed very little difference in the operation.

20. We have also maintained local control by creating 26 operating regions, each having regional directors to provide advice and direction into the decisions that must be made at the local levels.

21. Therefore, we have gained the best of both worlds. We have become more efficient and effective by combining our capital and human resources. And we have maintained, and in certain respects, increased our local, grass roots input and control of PCA operations. To provide you with a comprehensive list of these achievements, we have attached a list of our Accomplishments and Objectives for First South PCA.

WHAT ARE CONDITIONS LIKE THROUGHOUT THE SYSTEM?

22. As you know, the Farm Credit System is undergoing considerable stress now. The 37 banks within the System are mutually obligated to stand behind our bonds sold on Wall Street. This combined strength has provided us with a dependable source of funds for the past several decades. And it has provided our farmer/members with traditionally competitive lending rates.

23. But in a sense, the 37 Banks have all signed each other's notes. Therefore, the FICB of Jackson is obligated and has provided assistance to other districts that are experiencing financial difficulty. This action has been necessary, and it is indicative of one of the strengths of the cooperative nature of our system.

24. Unfortunately, the Fifth District FICB/PCA has reached the point where we cannot come to the aid of other districts without seriously threatening the viability of our own organization. We have done everything within our control to maintain viability within our own operations without asking for outside help.

25. The FICB of Jackson has infused capital into troubled Farm Credit Districts. This action has weakened our liquidity position, and we cannot continue to deplete our capital. Such action would ultimately cause us to seek outside assistance.

SUPPORT OF PROPOSAL FOR FARM CREDIT SYSTEM SELFHELP AND FEDERAL ASSISTANCE

26. Therefore, we come to you today to join in support of the efforts of the Farm Credit Council to request government financial assistance for the Farm Credit System. Without such assistance, we are deeply concerned about the lack of stability throughout the System as a whole. And we are distressed about the likely impact this will have on farmers throughout our nation.

27. We feel we must state, however, there are certain actions we do not want the government to take:

- First, we don't want the government to turn our system into simply another government agency. This alternative would bring about a never-ending burden for the American tax payer, and it would erase local grass roots involvement.

- Second, we don't want the government to block mergers within our System. We feel such mergers are a necessary and constructive means for local associations to take control over their own situations and regain stability within their operations. We believe this action has brought about greater efficiency, effectiveness, and grass roots control over our situation. We have provided you with a brochure entitled "Call for Action," which we feel describes in greater detail why it is necessary for association mergers to continue to take place.

28. We need assistance to help strengthen the system during this difficult period. But we do not want to be dependent on government assistance forever. We want to be able to maintain our viability and become capable of repaying this government financial help at the earliest opportunity.

29. When the PCAs were formed over 50 years ago, we began with seed capital from the government to help us survive those early, formative years. Eventually, we were able to pay back all of that seed capital and create a fully independent system of farmer-owned financial cooperatives.

30. Now we come to ask you to help our system survive this period of great financial stress. Once again we need government assistance. And as in the case of our early years as a system, we will eventually pay back every nickle of government financial help we receive.

31. Again we emphasize that the real problem is a lack of profitability in American agriculture. And the only solution to that problem is to improve profitability.

32. We want to express our sincere appreciation to you for allowing us to tell our story - that we as grass roots farmer/members of our PCA, when provided with the right information and opportunity, can and will make courageous decisions to solve our own problems and establish the course of our own destiny.

33. Thank you for giving us this opportunity. You and your colleagues are being called upon to make some very courageous decisions concerning the American farm economy. Your decisions will undoubtedly have a profound and lasting impact on nearly every farmer in this country. And we are confident that as you consider these proposals you will keep America's need for the production of food and fiber always at the forefront of your decisions.

FIRST SOUTH PCA INTEREST RATES

Association	Before Merger Int. Rate August, 1985	After Merger Int. Rate September 1, 1985	Decrease in Int. Rate Charged to Members
Coosa Valley	12.25	10.70	1.55
Demopolis	11.50	10.70	.80
Huntsville	11.50	10.70	.80
Montgomery	12.25	10.70	1.55
Russellville	12.95	10.70	2.25
South Alabama	11.65	10.70	.95
Southwest MS	12.25	10.70	1.55
First Delta	12.25	10.70	1.55
Hattiesburg	13.00	10.70	2.30
Central MS	12.50	10.70	1.80
Northeast MS	12.50	10.70	1.80
Oxford	12.00	10.70	1.30
Baton Rouge* (1)	10.40	10.20	.20
(2)	10.65	10.45	.20
(3)	10.90	10.70	.20
(4)	11.40	11.20	.20
Pelican	11.75	10.70	1.05
Opelousas	12.75	10.70	2.05
Tallulah	12.50	10.70	1.80

* Baton Rouge uses differential interest rates.

ACCOMPLISHMENTS & OBJECTIVES
FICB OF JACKSON & FIRST SOUTH PCA

1. Reduced FICB budget by $1 million, or 15% of the 1985 budget, approximately 25% of the controllable budget (uncontrollable budget now runs 30% of the total budget).
2. Reduced PCA 1986 operating budget expenses by $2.5 million or 15.3% from 1985 projected operating expenses.
3. Set up workout centers for liquidating loans
4. Moving toward top, hands-on management, working in close coordination to serve the needs of the members - 26 operating units - 87 branch offices
5. Salary administration and incentive plan to promote efficient and effective service resulting in positive bottom-line results
6. Directors will provide overall direction in policy, planning and controls (directors will direct)
7. CEO will work with both the FICB board and the PCA board on policy, controls and strategic planning (allows managers to manage)
8. Centralized capital and human resources
9. Decentralized loan servicing and decision making
10. Established competitive interest rates
    - Effective September 1, the FICB spread will be 50 basis points which will convert to a loan and discount rate of 9.70%
    - PCA spread will be 100 basis points which will equate to a 10.70 interest rate to members.
    - We will install differential interest rates.
    - We will install a matched funding (fixed rate) program
11. Maintain grass roots input and counsel through regional directors
12. FICB anticipates returning 100% of earnings in cash to the PCAs and ACCs
13. FICB has a very strong capital and liquidity position to assist the troubled PCA.

Page 2

14. CEO in dual capacity has direct control over both corporations, thereby assuring quality and control between the two corporations

    - PCA retained risk funds are virtually wiped out and we must depend on FICB capital to pull PCA through these economic adversities

15. Financial service centers will provide professional services such as the sale of computer hardware and software, training, farm records, PCA marketing training, etc. to members, PCAs, ACCs and other business customers

16. The financial condition of the average farmer in the Fifth Farm Credit District is more depressed than anywhere in the nation. However, due to the strong leadership, courage to make difficult decisions, and deep commitment of the PCA board, we have been able to reorganize and survive and maintain our viability during the worst of circumstances

    - PCA directors (grass roots) provide strong leadership in the design of the reorganization and support of the merger of PCAs

    - Good control standards in place to assure sound and constructive credit administration practices

17. Due to centralization of human resources, we have been able to place our top employees in the most effective and efficient area of responsibility to fully utilize their respective expertise and talents

18. With the merger in place, we are now in a position to streamline our operations to be commensurate with loan volume and bottom line performance.

JDC/cm

10/28/85

(Attachment follows:)

CALL FOR ACTION

Issues Surrounding
The Fifth Farm Credit District's Strategy for Dealing with The Agricultural Economic Crisis

Prepared by
Federal Intermediate Credit Bank of Jackson
Jackson, Mississippi
September 1, 1985

Jack D. Condra
Chief Executive Officer
Federal Intermediate Credit Bank
of Jackson and
First South
Production Credit Association

September 1, 1985

PREFACE

Today's date - September 1, 1985 - marks the start of a new era in agricultural finance in the Fifth Farm Credit District, consisting of Alabama, Mississippi, and Louisiana. For today is the first official day of operations of First South Production Credit Association - a new concept in the delivery of farm credit and other financial services to American farmers. First South PCA has been formed through the merger of 16 PCAs in our three-state area. This merger has received a vote of approval from 92 percent of the members voting, and has involved the consolidation of all capital and human resources of the merging associations. The result has been a new PCA that will be geared to serving the farmer more efficiently and more effectively than ever before.

The unique quality of First South PCA is that it will be reducing its operating costs by consolidating all administrative functions. At the same time, it has improved the effectiveness and quality of service to its members by dispersing the lending authority to its regional and branch offices. Thus the association will be more capable than ever of delivering the quality service farmers deserve at prices they can afford.

But farmers continue to struggle today under extremely stressful economic conditions. Their main problem is a **LACK OF PROFITABILITY** brought about by falling commodity prices and rising operating costs. Until profitability is restored to American farmers, we will continue to see erosion of their equity and an increased number of foreclosures and bankruptcies.

The pages that follow contain responses to some very tough and hard-hitting questions about American agriculture. There are no easy answers to the farm problem in our country today. If there were, someone would have solved agriculture's problems long ago. But hopefully the discussion that follows may shed light on some of the changes that have been taking place in the Production Credit Associations of the Fifth Farm Credit District. We must all dedicate ourselves to helping find ways to restore profitability to American agriculture, for that is the only way to solve the plight of our nation's farmers.

Jack D. Condra

1. How severe is the ag economic crisis in America today?

- Major problem - LACK OF PROFITABILITY
- Gap between total debt and net income growing wider
- Land values continue to drop
- Farmer's equity squeezed out

The major problem facing farmers today is a LACK OF PROFITABILITY. The unprecedented inflation of the late seventies caused farm operating expenses to rise dramatically. Unfortunately, commodity prices did not keep pace with these rising operating costs, thus making farming very unprofitable. And because farming has been so unprofitable, farmland values have been tumbling. Furthermore, the gap between the typical farm debt load and the net income produced by that farm has widened tremendously. Thus, the equity a typical farmer owns in his business has been squeezed out by falling land prices and rising debts. And this loss of equity and lack of profitablility have made it impossible for many farmers to service their ever-growing debt loads.

2. What steps are PCAs taking to deal with this crisis?

- Going extra mile with needy borrowers
- Restructuring organizations
- More efficient business operations
- Continued competitive rates

Because each PCA is owned by its borrowers, it has been especially willing to go the second, third, and fourth mile with those borrowers experiencing special difficulties. Loan extensions, renewals, and voluntary liquidations have been common examples of such efforts. Furthermore, it is mutually beneficial to both farmers and their lenders that the farming community remain financially healthy. Therefore, PCAs have been working closely with borrowers to help them resolve their financial difficulties.

In a recent move to address the agricultural economic problems confronting the farmers of Alabama, Mississippi, and Louisiana, the directors of Fifth District PCAs took bold and decisive action in proposing a merger of their respective associations. This merger, which was approved by 92 percent of the members voting, will make these PCAs more efficient and will help to keep down the costs associated with administering and servicing the loans of their borrowers. In fact, the cost savings associated with the merger of these associations has enabled them to continue offering competitive rates to their member/borrowers. The new association formed by this merger officially became effective on September 1, 1985 under the name of First South PCA.

Are lenders having financial difficulties also?

- Farmers and lenders have paid dearly
- Total Fifth District PCA loan losses in 1983 and 1984 alone more than doubled total loan losses for previous 50 years
- More losses anticipated for 1985

In going the extra mile with borrowers, PCAs have experienced severe losses due to the stressful economic conditions their members are experiencing. Until 1983, the total amount of loan losses Fifth District PCAs had incurred since their formation in 1933 was $ 21 million. In 1983 alone, PCAs lost over $24.5 million. Losses for 1984 were about $23.6 million. And heavy loan losses are projected again for this year. Other agricultural lenders, including commercial banks, have suffered similar levels of loan losses. There should be no question that both PCAs and commercial lenders have "gone the extra mile" in working with their borrowers to fulfill their financial obligations.

Why should farmer/members be concerned about their PCA taking loan losses? Don't PCAs need to stay with borrowers longer in order to ease farmers' financial burders?

- Dual responsibility
- Needs of individual member vs. needs of total membership
- Loan losses are paid for by the members through higher interest rates

Farm Credit institutions have a dual responsibility. On the one hand, they must be sensitive to the financial needs and conditions of individual borrowers. On the other hand, they must consider the welfare of the association membership as a whole. Consequently, when a PCA stays with a borrower too long and suffers a loan loss as a result, the remaining members of the association bear the burden of this loss. And they bear this burden in the form of higher interest rates.

As an illustration, consider what happens if a PCA with a $30 million loan volume loses $1 million. Typically, an association this size would have about $4 million of its own funds invested in the loan portfolio and would be borrowing about $26 million from the Federal Intermediate Credit Bank to finance the balance of its lending operation. If $1 million of the $30 million is written off the books as losses, the PCA will now have $29 million, from which it can continue to generate income that will pay its operating expenses and build capital for future growth. This means that, because of the $1 million loss, those farmers who have the $29 million in loans will have to pay almost one-half of one percent more in interest rates in order to maintain the same level of income to pay expenses and build capital.

It is for this reason that PCAs must balance their responsibility to the individual farmer with their responsibility to the entire membership of the association when considering individual loans and when assessing the risk involved.

5. Who controls the operations of each production credit association, including the newly formed First South PCA?

- Membership elects PCA Board members and Regional Directors
- PCA board provides overall policy direction and control.
- Board delegates operational authority to CEO

The PCA board members are elected by the membership of their association. They are responsible to the membership for providing positive direction and leadership and for protecting the assets of the association. The PCA board provides overall policy direction and control of the PCA in carrying out the mission of the association. The PCA CEO, in turn, controls the day-to-day operations of First South PCA and implements the policies and directives of the association. Through his leadership and direction, the PCA carries out its various functional responsibilities of providing credit and related services to its member/borrowers. Also, regional directors provide local advice and counsel to regional management in carrying out the business of the PCA.

6. **How do PCAs obtain the funds to lend to farmers?**

- o Funds obtained through sale of Farm Credit bonds
- o Backed by collective obligation of all Farm Credit institutions
- o Reliable source of funds
- o Produces competitive rates for borrowers

PCAs obtain funds primarily by borrowing from Federal Intermediate Credit Banks. In so doing, they also purchase stock in the FICBs, and thereby become the primary stockholders in each bank. The FICBs, in turn, join the other banks of the Farm Credit System in selling Federal Farm Credit Consolidated Systemwide Bonds. These bonds become the collective and individual obligation of the 37 Farm Credit Banks and, therefore, are backed by the combined strengths of the Federal Land Banks, the Federal Intermediate Credit Banks, and the Banks for Cooperatives. This combined strength and long record of stability of the various institutions of the Farm Credit System have allowed our bonds to carry very favorable interest rates in relation to market conditions. These more favorable rates have, in turn, been passed along to the PCAs and farmer/members in the form of traditionally competitive lending rates.

7. **Why are various associations trying to merge their organizations?**

- o Mergers are a means to maintain a viable business.
- o Strengthens assets of merging associations
- o Adds stability to association
- o Provides greater protection for stockholder equity

- Occurs only through authorization of the member/borrowers
- Effective form of "self-help"

The recent moves to merge associations in various districts have not come about as a means for management to reduce member/borrower control of the business. Rather, they have come about as a means for PCA boards and management to maintain a viable business. The various institutions of the Farm Credit System are now undergoing tremendous financial stress. In some cases, associations have run into considerable financial difficulty and have had trouble remaining in business. In the Fifth Farm Credit District a task force of PCA directors was formed to search for an appropriate strategy for addressing this problem. The strategy selected was to seek a merger of district associations that would preserve a competitive position, ensure continued viability in the district, and enhance quality of service and cost efficiency in providing sound and constructive credit and related services to members.

This has been an effective strategy for strengthening the assets of the constituent associations. It has been a means of bringing considerable stability to the operations of the merged organizations. And it has thereby served to provide greater protection for the equity of its member/borrowers. Furthermore, this merger has come about only through the collective authorization of the member/borrowers. As such, it has been an effective form of "self-help" - a means by which a group of Farm Credit organizations have attempted to solve their own problems without outside assistance.

8. **Why do associations come to the aid of other associations that are having problems?**

- Part of cooperative system
- Each PCA shares in the Systemwide obligation to bond holders
- Failure of one increases relative liability of all others
- In best financial interests of each to assist each other

The associations of the Farm Credit System are all cooperatives; they are owned by the farmers who borrow money from them.

Furthermore, the stability of the system as a whole is dependent on the stability of the various institutions that make up the system. Therefore, the financial stability of any one association is very much a concern to the other associations within its district and throughout the rest of the system.

As previously stated, the member/borrowers who own the various associations of the Farm Credit System have enjoyed comparatively modest interest rates as a result of their combined strength. No individual association could enjoy such a sustained access to competitively priced funds without the combined strength of all of the other associations. But with this privilege come certain obligations. In particular, each association (through partial ownership in its respective Farm Credit Bank) is obligated to stand behind the worth of the various systemwide securities that are issued to investors (the System's source of funds for loans). Therefore, the failure of one association increases the relative liability of each other association.

Thus, it is because of the system's cooperative structure that all associations are obligated to assist associations that are experiencing financial difficulty. And it is in the best financial interests of each association to honor these obligations.

9. **What advantages are realized, then, by merging the association? Can't you save the system simply by helping the weaker organizations when they need help, and not actually merging the resources of various associations?**

- If losses are shared, this tends to weaken other PCAs
- As new PCAs need help, stability of system as a whole is shaken
- Bank assistance results in increased cost to members
- No magic pot of money
- Larger capital base produced through merger provides greater protection against loan losses
- Helps to streamline PCA operations and reduce expenses

It is true that the associations in any one district may come to the aid of a failing association by sharing in the costs resulting from loan losses. It is also true that the Farm Credit Bank for that district may infuse capital into the failing association to bolster its financial structure. Various problems, however, result from such strategies.

First, all of the PCAs participating in the exercise of a loss sharing agreement become somewhat weakened by this participation. Such a move tends to particularly affect financially weak associations, making them more vulnerable to adversity. Then, if these associations require assistance, the loss sharing agreement may be exercised again, causing still more financial damage to the participating PCAs.

In the case of a Farm Credit Bank infusing capital into a failing PCA, the other district associations will not immediately be weakened as they would be under the earlier scenario. Nevertheless, the bank would be forced to increase its interest rates to the associations. This action would be required to make up for lost revenues no longer realized by the bank from the capital infused into the PCA. Such revenues are used to cover operating expenses, to sustain a reserve for bad debt, and to establish a financial reserve for the bank.

Therefore, there is no magic pot from which anyone can draw money in order to recoup loan losses. Such losses must be paid for ultimately by the members themselves.

Merging the capital and human resources of associations helps to overcome such problems. The larger capital base of the merged association provides greater protection for the association in the event of loan losses. And by concentrating many of the administrative functions into one location, the PCA is able to streamline its operations, reduce its expenses, and focus its attention on making and servicing loans at the local level.

10. **But don't the member/borrowers lose control within their association once a merger takes place?**

- Very little change for the member
- Move to localized lending authority

- Regional and PCA board director representation

The member/borrowers actually experience very little change in operations after a merger takes place. In the case of Fifth District PCA mergers, lending authority will be localized. That is, the making and servicing of loans will be focused increasingly at the local branch office level. The result will be direct service to the member/borrower.

Furthermore, members retain control of their association through their elected regional and PCA board directors.

11. **What advantages do members have by merging their associations?**

- Allows retention of dependable and competitive source of funds
- Provides funds at relatively favorable rates
- Provides greater protection of member stock
- Allows potential for expanded member services

The primary advantage members have in merging their associations is they will be better able to retain a dependable source of funds at competitive rates. Without merger, many associations would cease to exist, and the stability of the district and the system as a whole could be endangered.

A second advantage is that the stability of a large, merged association provides greater protection of member stock in the association.

Thirdly, a larger association has the potential to provide expanded member services.

In summary, the merger of associations in the Fifth District offers a viable course for PCAs to follow. It is a course by which PCA directors and members are showing considerable courage and initiative by taking control of their situation and developing solutions that produce the greatest level of service to the member/borrowers.

Production Credit Association of South Texas

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September 24, 1985

The Honorable Kika de la Garza
U. S. House of Representatives
House Office Building
Washington, D. C. 20515

Dear Mr. de la Garza:

The Board of Directors of the Production Credit Association of South Texas would like to voice their opinion regarding a regulation which was recently approved by the Federal Farm Credit Board and published in the Federal Register. We are adamantly opposed to the regulation and seek your assistance in preventing this regulation from becoming effective.

Briefly stated, this regulation grants the Governor of the Farm Credit Administration the authority to transfer assets among Farm Credit institutions. Section 5.18 of the Farm Credit Act of 1971 clearly defines the role of the Farm Credit Administration and its Governor as supervisors, regulators and examiners of the system. We do not believe that it was the intent of Congress to empower the Governor in the manner in which this new regulation does and that he is circumventing congressional authority by manipulating the Federal Farm Credit Board into granting him such broad power. We contend that if the Governor, at his sole discretion, is allowed to transfer assets out of the stronger Farm Credit Districts to the weaker districts in the country, this forced transfer of assets will drain the stronger districts of their reserves and leave them vulnerable to the losses that are to be anticipated given the depressed state of the agricultural economy.

In further support of our contention that this so called "emergency regulation" was passed by the Federal Farm Credit Board as part of a power play by Governor Wilkinson to gain dictatorial control of the Systems assets, let us remind you that the System itself has chartered the Farm Credit Corporation of America. This central organization has the responsibility for national planning for the Farm Credit System. The Corporation's President, Alton B. Cook, stated in a news release of September 9, 1985 that the Systems Board of Directors and Bank Presidents had planned for several months to present their plan for the System during this month. However, "the unilateral actions announced by the Farm Credit Administration earlier this week have preempted the orderly consideration of these issues by the System". Thus it appears that the governor is not only circumventing Congress, he is circumventing the Farm Credit System as well.

Branch Offices Edinburg (512) 380-0078, Hebbronville (512) 527-3297
Laredo (512) 723-4521, Raymondville (512) 689-5502

As you may know, the Texas District is one of the financially strongest Farm Credit Districts in the nation. True, we may be able to give some credit for our financial strength to favorable weather and good luck, however, we maintain that our strength is a direct result of many of our association's boards and management adhering to sound credit policies and basic cash flow lending. As one journalist put it "during the go-go 1970's the system seemed to run wild". During this time the Farm Credit Administration was advocating quantity instead of quality and growth into areas of lending beyond the systems' expertise and original purpose. Many associations in the Tenth District chose not to follow the whims of FCA and are still quite viable today. We can sight several examples of association's within the district whose board and management knuckled under to FCA only to have their association end up broke and in need of financial assistance.

Many of the recent publicized statements which Governor Wilkinson has made regarding the financial condition of the Farm Credit System again exemplifies our assertion that the governor is an irresponsible powermonger. His distorted and misleading statements about the system have already triggered a negative reaction in our bond market. This has driven up the cost of our money at a time when our member/borrowers can least afford it. Even the commercial banks in Texas with which our District Bank in Austin has for years borrowed large sums of short term funds on an unsecured basis are now asking that these credit lines be collateralized. Furthermore, Governor Wilkinson never informed any of the district banks prior to the publication of his defamatory statements. Proof again that this is bureaucratic maneuvering on the part of the governor to gain control of the assets of the System before the System itself has the opportunity to refute his statements and present its plan for the survival of the System.

We ask you, if any other corporate CEO had caused his company as much damage as Governor Wilkinson has caused the Farm Credit System, would he be given more control of the corporation? Absolutely not! In fact, any good business firm would relieve the CEO of his duties immediately. We expect nothing less for the Farm Credit System.

Sincerely,

Francis L. Phillipp

Francis L. Phillipp, Chairman
Board of Directors

(Attachments follow:)

Original to: Mr. Donald E. Wilkinson
Originals to: Rep. Kika de la Garza
Rep. Solomon Ortiz
Senator Phil Gramm
Senator Lloyd Bentsen

Copies to: Senator John Heinz
Senator Jesse Helms'
Senator Mitch McConnell
Sanator David Boren
Rep. Charles W. Stenholm
Rep. Cooper Evans
Rep. Leon Panetta
Rep. San Hall
Rep. Ralph Hall
Rep. Tom Loeffler
Rep. Charles Wilson
Mr. Wilmer Smith
Mr. B. L. Wmith, Jr.
Mr.W. Clyde Ikins
Mr. Ben F. Gearhart, Jr.
Mr. Edward Breihan
Mr. Ray Robertson
Mr. George Steele
Mr. Crete D. Harvey
Mr. Mervin A. Ensley
Mr. Joseph A. Kyser
Mr. Paul I. Enns
Mr. Tom Carothers
Mr. Leonard R. Fouts
Mr. Ralph Ball
Mr. W. Proctor Scarboro
Mr. Ralph Raikes
Mr. William D. Wampler
Mr. Jewel Haaland
Mr. Dwight L. Tripp
Mr. Leo Newsom - Winter Garden PCA
Mr. L. B. Bellah, Jr. Wichita Falls PCA
Mr. William Magee, Jr. - Waco PCA
Mr. Leslie Laffere - Uvalde PCA
Mr. Haskell L. Miracle - Tyler PCA
Mr. R. B. Ferguson - Texas PCA
Mr. A. K. McCarley, Jr. - Sweetwater PCA
Mr. R. W. Evans - Stephenville PCA
Mr. W. J. Boykin - Rolling Plains PCA
Mr. T. J. Tigner - Richmond PCA
Mr. H. L. Porter, Jr. - Plainview PCA
Mr. Shelby J. Harper - North Texas PCA
Mr. William C. Donnell - Marfa PCA
Mr. Cleve Littlepage - Lubbock PCA
Mr. Weldon Laas - Farmers & Ranchers PCA
Mr. Leo J. Allenson - El Campo PCA
Mr. David Thornton - East Texas PCA
Mr. Marvin Henderson - Corsicana PCA
Mr. Harold Price - Coleman PCA
Mr. Wayne E. Mengers - Coastal Bend PCA
Mr. Verlin Callahan - Central Texas PCA
Mr. James Johnson - Cattlemen's PCA
Mr. Lloyd R. Buzzard - Canadian PCA
Mr. Robert A. Harris - Bryan PCA
Mr. O. B. Utley, Jr. - Blacklands PCA

Mr. M. L.Welch - Beaumont PCA
Mr. George B.Doshier -
Amarillo PCA

Production Credit Association of South Texas

1221 North 77 Sunshine Strip
Post Office Box 2128
Harlingen, Texas 78550-2128
Telephone (512) 423-0817

September 24, 1985

Mr. Donald E. Wilkinson, Governor
Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22102-5090

Dear Governor Wilkinson:

The Board of Directors of the Production Credit Association of South Texas would like to voice their opinion regarding a regulation which was recently approved by the Federal Farm Credit Board and published in the Federal Register. We are adamantly opposed to the regulation becoming effective.

Briefly stated, this regulation grants the Governor of the Farm Credit Administration the authority to transfer assets among Farm Credit institutions. Section 5.18 of the Farm Credit Act of 1971 clearly defines the role of the Farm Credit Administration and its Governor as supervisors, regulators and examiners of the system. We do not believe that it was the intent of Congress to empower the Governor in the manner in which this new regulation does and that he is circumventing congressional authority by manipulating the Federal Farm Credit Board into granting him such broad power. We contend that if the Governor, at his sole discretion, is allowed to transfer assets out of the stronger Farm Credit Districts to the weaker districts in the country, this forced transfer of assets will drain the stronger districts of their reserves and leave them vulnerable to the losses that are to be anticipated given the depressed state of the agricultural economy.

In further support of our contention that this so called "emergency regulation" was passed by the Federal Farm Credit Board as part of a power play by Governor Wilkinson to gain dictatorial control of the Systems assets, let us remind you that the System itself has chartered the Farm Credit Corporation of America. This central organization has the responsibility for national planning for the Farm Credit System. The Corporation's President, Alton B. Cook, stated in a news release of September 9, 1985 that the Systems Board of Directors and Bank Presidents had planned for several months to present their plan for the System during this month. However, "the unilateral actions announced by the Farm Credit Administration earlier this week have preempted the orderly consideration of these issues by the System". Thus it appears that the governor is not only circumventing Congress, he is circumventing the Farm Credit System as well.

COPY

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Sincerely,

Francis L. Phillipp

Francis L. Phillipp, Chairman
Board of Directors

cc: Representative Kika de la Garza
Washington,D. C.

AGRICULTURAL CREDIT CONDITIONS

THURSDAY, OCTOBER 31, 1985

House of Representatives,
Subcommittee on Conservation, Credit,
and Rural Development,
Committee on Agriculture,
Washington, DC.

The subcommittee met, pursuant to notice, at 9 a.m., in room 1302, Longworth House Office Building, Hon. Ed Jones of Tennessee (chairman of the subcommittee) presiding.

Present: Representatives Weaver, Glickman, Daschle, Stenholm, Tallon, Thomas, Stallings, Coleman, Jeffords, Morrison, Gunderson, Evans of Iowa, and Franklin.

Also present: Representative E (Kika) de la Garza, chairman of the committee; Representatives Bedell, Huckaby, Volkmer, Olin, Penny, Madigan, and Schuette, members of the committee; and Representatives Alexander and Smith of Nebraska.

Staff present: Phillip L. Fraas, counsel; Robert T. Lowerre, associate counsel; Cristobal P. Aldrete, special counsel; Charles Hilty, minority staff director; William E. O'Conner, Jr., assistant minority staff director; John E. Hogan, minority counsel; Mark Dungan, minority associate counsel; Glenda L. Temple and Francie Monaghan, clerks; Bernard Brenner, Howard Conley, Robert A. Cashdollar, James W. Johnson, Jr., Susan Adkins, and Fred Clark.

OPENING STATEMENT OF HON. ED JONES, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE

Mr. Jones of Tennessee. Good morning, ladies and gentlemen. The Subcommittee on Conservation, Credit, and Rural Development will come to order.

We are now ready to launch out on another long day of farm credit hearings. We are delighted that you are here. We hope that you can spend the day with us, and I guarantee that you'll have company because we are going to be here all day.

Our first witness this morning is the Governor of one of our great agricultural States, and for the purposes of introduction I yield to our good friend, a member of the subcommittee, the Honorable Cooper Evans.

Mr. Evans of Iowa. Well, thank you, Mr. Chairman. I appreciate the chairman yielding to me for this purpose.

It is indeed my privilege and pleasure to introduce the Governor of my State, the Honorable Terry Branstad. He is a long-time personal friend of mine. We have served together in the Iowa General

Assembly, and I am just delighted that he is here to appear before this subcommittee today, Mr. Chairman.

I think it is important to point out, Mr. Chairman, that Governor Branstad is not only the Governor of Iowa, he is the chairman of the Ag Committee of the National Governors' Conference, and, while he is here speaking for himself personally, he also has those other duties and I know has conferred with many of his colleagues on that committee within the last 24 hours on the nature of this problem. It is indeed a pleasure to introduce to you the Governor of the State of Iowa.

Mr. JONES of Tennessee. Thank you very much, Cooper.

We are delighted that you are here, Governor. We are very anxious to hear your testimony and, without further ado, you may proceed.

STATEMENT OF TERRY E. BRANSTAD, GOVERNOR, STATE OF IOWA

Governor BRANSTAD. Thank you very much.

Chairman Jones, Congressman Evans, other members of the subcommittee, I appreciate this opportunity to visit with you today about the farm-credit crisis that exists in America. I would like to commend the subcommittee for holding these hearings on this very critical problem.

My message today is very simple and clear: Our Nation's Farm Credit System is being sucked in to a financial whirlpool, and we must take action to prevent our Nation's food producers from drowning. I believe that it's imperative for the administration and the Congress to work together on a farm-credit package that will restore stability to agriculture before you go home for your Christmas recess. If you fail to respond to this important challenge, thousands of farmers throughout the country will be forced off their land in a winter of discontent, and our Nation's Farm Credit System and indeed our entire financial structure will be put in jeopardy.

Now I know these are strong words, and that there are many that wish this problem would simply go away, but strong words are needed to reflect the grim reality that's facing our Nation's heartland at this time. The problem will not go away, despite the fervent wishes of some bankers on Wall Street and some officials here in Washington.

For over 1½ years now I have been sounding the call to take action to deal with our Nation's farm credit crisis. While some tentative steps were taken last winter to provide guarantees for operating loans, no significant action has been taken to deal with the core of the problem—a dramatic decline in this Nation's land values that has sucked wealth and actual life out of rural America.

For over 1½ years we in the heartland of this country have warned you. We have warned you in Washington that the financial sickness in rural America could spread to our urban streets as well. Despite our warnings, significant action has not yet been taken. Today I am here to warn you that we can wait no longer. If you do not take action this year to stop the hemorrhaging in our

Nation's farm financial system, none of you will be spared from the bleeding.

I know that yesterday you had the opportunity to visit with officials from the Farm Credit System and to hear their perspectives about this problem, and I'm sure that you have received other documentation of the gravity of the problem that faces us as a Nation. However, let me outline for you at least two reasons why there is a need for immediate action to deal with the farm credit crisis.

One, the problem is getting worse. Last January when I visited with key Members of Congress and the administration, I indicated that 30 to 40 percent of our Nation's farm debt was in trouble. Today a study will soon be released by Iowa State University that indicates that 73 percent of farm debt held by commercial banks has a debt-to-asset ratio of 40 percent or above. Eighty-one percent of the debt held by PCA's and 75 percent of the debt held by the Federal land banks is on this critical list, and unfortunately the problem will continue to grow worse before it gets better.

These same experts from Iowa State University have indicated that land values in the State of Iowa have dropped an additional 15- to 20-percent this year, on top of the 40- to 50-percent decline of the previous 4 years. Moreover, a soon-to-be-released study by the Economic Indicators Branch of the USDA will show that 60 percent of the debt held by the Farm Credit Administration in this country was held by farmers who were not cash-flowing in the year 1984.

These dramatic figures cannot help but have a devastating impact on the Farm Credit System and our Nation's entire banking structure. It has been indicated to me by officials in the Farm Credit System that, after necessary loss reserves are taken into account, a $1.5 billion loss is expected by the Farm Credit System during the year 1985, and the loss in 1986 is likely to be even larger.

If action is not taken soon by the Federal Government to stabilize the Farm Credit System, it is expected that 40 PCA's, 3 Federal intermediate credit banks, and 2 land banks will have to be liquidated, and thousands of farmers will be forced out of their homes and off their farms. In addition, interest rates for the remaining farmers will rise in order to absorb these loan losses. There will be far more farm foreclosures than we have witnesses to date. Frankly, by this time next year the Farm Credit System will likely be out of business.

I know that some believe that we should bleed the Farm Credit System dry before we provide a transfusion. I share the desire to make the Farm Credit System use its available reserves, but I respectfully request that you consider the fact that if we allow the Farm Credit System to go dry, there will be few available funds next spring to plant a crop, and the costs of the inevitable Federal bailout once those reserves are totally dried up will be many times what it is today. Allowing a system three times the size of the Continental Illinois Bank to go belly up will send serious shock waves throughout our Nation's entire financial structure.

In short, the need for Federal intervention is growing day by day. Many more farmers than ever before are in serious trouble. The farm financial institutions themselves are on the verge of collapse, and our Nation's financial stability demands action.

Two, I submit to you that the timing of your action this year could provide some real hope for our Nation's heartland. I believe that appropriate Federal action this year would result very quickly in a stabilization of land values. In combination with a farm bill that provides income protection, we could actually see some improvement in our Nation's agricultural financial system next year.

We need hope in the heartland. Right now despair reigns. Appropriate action by Congress this year will provide real financial and psychological lift to the people that are presently mired in despair. I know that action in the Congress has been stymied to date because of the lack of consensus for appropriate action but I don't believe that that has to be the case much longer.

Let me outline for you principles which could guide your actions. These principles have been agreed upon by the National Governors' Association. We had a conference call with nine Governors and several aides of other Governors just recently, and we were able to come to this consensus. I believe that these principles that the Governors have now agreed upon can serve as a road map for immediate action here in the Congress.

First, the focus of Federal assistance should be on benefiting farmers and their families as well as the credit system. We do not want the net result of Federal assistance to be the widespread loss of the private ownership of farmland in this country. We don't want the dislocation of farm families and we don't want an increase in tenant farming. We want to keep our farm families on the farms and maintain the best food production system in the world. If we do that, we will also help save thousands of small businesses in rural communities, school districts, rural police and fire protection, rural electric and other cooperatives, and a local government tax base that's very important in the heartland of this country.

Therefore, the Nation's Governors believe that assistance should be specifically targeted to the preservation of existing farms. It will be extremely costly, even wasted, if we stabilize the rural lenders and fail to stabilize the farmers. Last summer I outlined a number of ideas to stabilize the Farm Credit System, and today I am pleased to represent the Nation's Governors as we indicate what is needed to address it:

(a) Interest rate buy-down to allow eligible farmers to receive economic stability;

(b) A mechanism to restructure agricultural real estate loans to family farms, to avoid the further erosion of farm real estate values. The Governors believe that we should keep farmers on the land, and the title of the land should stay with the farmer wherever possible. Farmers need to have a reasonable opportunity to work out of the debt load, to the point where they can survive in the long run.

(c) An appropriate policy of forbearance in lieu of massive foreclosures of farmland. A policy of leaseback to farmers who have already been foreclosed should also be considered, to help stabilize rural America and further avoid the deterioration in land values.

No. 3, the farm credit crisis is much larger than the Farm Credit System. A program to assist only the Farm Credit System would be shortsighted and fall short of the assistance needed to enhance the agricultural economy.

The Nation's Governor's agree that we need to provide public input into the policy development of the Farm Credit System. Congress should require the Farm Credit System banks to hold hearings and allow public comment before policy changes are made in secret without farmer input. Moreover, we are concerned that the Farm Credit System, in its public effort to seek Federal financial assistance, has been vague in the manner in which the Federal moneys would benefit the farmer-members and stockholders. Experience has taught us that the Farm Credit System directors do not always provide accurate and timely information to their members and to the public.

For example, I warned the farm credit officials earlier this year that the system was headed for real trouble, but my warnings were met with an attack on my credibility. Three months later, they admitted they were in real trouble and couldn't handle their own problems. Even today I suspect that they do not fully understand the extent of the problems facing the system.

Now in the interests of time I will skip a section of my remarks, page 9 and the top two paragraphs on page 10, and conclude with the following:

As you know, I recently took extraordinary action in the State of Iowa by imposing a limited farm mortgage foreclosure moratorium. This step was unprecedented in modern times. It was a step that has been questioned by some, but I want you to know that this action was taken because I see a critical need to buy some additional time for many farmers in my State. I also want to send a very clear signal to you, the decisionmakers here in Washington, that we need help in the heartland of this country. I ask you to heed that warning and turn the despair in the heartland into hope. We need action, and we need it this year.

Thank you, Mr. Chairman.

[The prepared statement of Governor Branstad appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Governor. If you will, remain where you are and give the committee members time enough to ask you some questions.

Mr. Coleman, I yield to you 5 minutes for questioning.

Mr. COLEMAN. Governor, if you have warned the Farm Credit System this year, some of us warned them a whole year and a half ago. We feel their response is the same one that you feel that you got, which was, "We can handle this by ourselves. We know what we are doing." I pointed out yesterday that that statement was made as late as August of this year. Thirty days later the Governor of the Farm Credit Administration reversed his field and position and said that they needed assistance, and of course that's why we are here today.

Obviously you don't need to warn anybody in this room about the crisis in rural America. We are very much aware of it. We live with it constantly, as you do. It's a rather depressing thing, but there are no short-term solutions and there are long-term answers that don't appear to be coming very quickly.

If you are sending us signals to Washington and we are sending you farm bills, do you feel that the farm bill that we passed here in the House is the type of response that you would have signaled to us to provide to rural America?

Governor **Branstad**. Yes; I want to compliment the House of Representatives on the farm bill you have passed. I know it is being debated in the Senate at this time. I think it sends a very positive signal because it says we are not going to put farmers out to sea, so to speak. We are going to provide some stability and retain the target price system over the next 4 or 5 years, and I think that's important. I think that provides some income assurance and will help provide stability, and I think the combination of the passage of that bill or something similar by the Senate, hopefully signed by the President, along with action on the farm credit situation, could in fact stabilize land assets and provide the real hope we need in the heartland of this country.

I have visited with you and your staff and I know that your situation, in a neighboring State to mine, is very similar to ours as it is all throughout the heartland of this country. We need some hope. The farm bill I think is a major step forward. I would hope that the farm credit issue will also be addressed. The combination of those two I think can help stabilize the situation.

Mr. **Coleman**. Are you suggesting to us today that when we respond to the farm credit problem, that we ought to be more concerned than just the Farm Credit Administration and its system, but expand our concern to commercial banks and other lenders? Or do you feel we ought to isolate this problem and address just the Farm Credit System now?

Governor **Branstad**. Congressman, I don't believe that it's an isolated problem, and I think it needs to be addressed in a way that will help farmers, not bail out a system that has not leveled with or been honest or straight with you or with the farmers, but we need to provide help to farmers. We need to provide forbearance. We need to make some assurance that the help that is provided to the system is actually going to help farmers.

Frankly, in light of the experience of the last year and a half or so, a lot of farmers question whether they can trust the Farm Credit System itself, so I think you need to build in some safeguards and some guarantees and recognize the fact that the system only represents a part of the agricultural financing that is needed in rural America, and consequently a limited solution—one that just bails out the system—is not adequate.

Mr. **Coleman**. Your foreclosure moratorium in Iowa, does that just pertain to State chartered banks and lenders, or how broad? I assume this is being tested in the courts.

Governor **Branstad**. Well, we expect that it will be tested. Now let me tell you we feel very confidently that the mortgage moratorium applies to all farm real estate mortgages with the exception of the Farmers Home Administration mortgages, which are already affected by a Federal district court decision made in North Dakota.

We expected, however, that the Farm Credit System would challenge it. The day after I signed the moratorium, in our district, which is governed by Omaha, the word came out of Omaha that they were not going to challenge it. We expected they were, and we had done the legal research, and we feel confident that it does apply to the Farm Credit System. We were told they weren't going to challenge it, but here we found out just last Friday that while the people in Omaha were saying they weren't going to challenge it, they accepted the State's jurisdiction, the people in Washington have planned an emergency rule to try to circumvent the mortgage moratorium. Frankly, if they file that—and we have been waiting day-by-day, we have been rumored that it is going to be in the Federal Register any day—as soon as it is, we intend to go in and seek injunctive relief to ensure that the mortgage moratorium I have signed in Iowa will continue to be in place and provide protection and buy the time the farmers need.

Mr. Coleman. Well, Governor, thank you. Let me say that Iowa's interests are well represented on our committee, and especially in our subcommittee here with Mr. Evans, who is certainly on top of the situation and very knowledgeable and who is certainly an asset to all of us as we grapple with this very complex problem.

I thank you for coming today.

Governor Branstad. Thank you, Congressman.

Mr. Jones of Tennessee. Thank you very much, Mr. Coleman.

Now I yield to Mr. Stenholm 5 minutes for questioning.

Mr. Stenholm. Thank you, Mr. Chairman.

I want to go a little bit further, Governor, with you in the decision that you made regarding the moratoriums. What has been the result in Iowa after you have made that action, and what do you believe today is going to be the end result of that decision that you made?

Governor Branstad. First of all, I think you need to understand that our State moratorium law is very limited. It is limited to farm real estate that is in the process of foreclosure. A farmer who is being foreclosed upon can go to court and ask for a moratorium, so it's not self-executing. The farmer actually has to go in and ask for it.

There are cases pending. There is at least one case that has already been decided in favor of the farmer. There are other cases that are pending that would buy some time and grant a moratorium for these farmers.

More significant than that, however, is the fact that to date it has prevented the Farm Credit System from moving forward with a massive number of farm liquidations that they have contemplated. Now we can't get totally accurate information out of the Farm Credit System, but through the sources that we have been able to glean information from, we had reason to believe that literally hundreds if not thousands of foreclosures are planned in the next several months.

Obviously, we may have to go to court to continue to enforce this, but it's on the books. I have signed the executive order implementing it, and we are working with the State of North Dakota and the Governor and attorney general there, as well as my own State, to enforce it. To date, I think, it has been significant.

Just as important as what it has done is the signal and the message that it sends to the administration and to the Congress, and that is, this situation is very desperate, and the situation this winter is going to be many times worse than it was last winter. It is not going to go away by ignoring it. We need action, and we need to see action before the end of this year. That's the reason why I did it, more than anything else, was for people here in Washington who seem to be oblivious to what is happening in the heartland of this country, to say, "Wake up. Let's not wait until we have blood all over the streets. Let's take some action now when we can really do some good and help stabilize the situation and prevent it from getting worse."

Mr. STENHOLM. In your own opinion, why is Iowa and the heartland of America or the breadbasket of the world experiencing the severity of the problem, when other States are having problems but not nearly as severe as your State?

Governor BRANSTAD. We are the leading farm State, and we're right in the heart of it. Frankly, we led the States when land was going up and we're leading them on the way down, and they're right behind us. The problem in Missouri, Kansas, Nebraska, the Dakotas, Illinois, and Minnesota, is not that different from Iowa.

It just so happens that Iowa is a very strong agricultural State and our entire State is affected by agriculture. Some of these other States, maybe it's another industry that is more the dominant industry, but in our State agriculture is the dominant industry. Agriculture is important in all sections and all parts of our State.

Mr. STENHOLM. There is no question that very little of agriculture is profitable today, but you said one thing—land prices went up. Do you attribute the problems in Iowa to the fact that land prices went up too high?

Governor BRANSTAD. I think everybody would admit that land prices went up too high during the 1970's. During an inflationary period we saw land prices go way up too high, and now we've got just the opposite happening. We have land prices that are dropping. They are dropping like a rock. They have dropped in some cases below what would be the reasonable return on investment if farmers had an assurance that the target price system would remain intact.

Frankly, we have a situation now where we have such a lack of confidence that people are sitting on the sidelines that might otherwise be interested in agricultural real estate and are saying, "It's a down market and we'll just wait until they foreclose on all these people, and we'll pick it up at bargain-basement prices." I think that's absolutely wrong, and I think action here could help stabilize that situation and prevent—we had this big up spike and now we're going to have a big downspike, and we need to gently stabilize the situation to prevent the kind of massive displacements that otherwise would occur.

Mr. STENHOLM. Thank you, Governor.

Mr. JONES of Tennessee. Thank you, Mr. Stenholm.

Now to Mr. Evans for 5 minutes. I recognize you.

Mr. EVANS of Iowa. Well, thank you, Mr. Chairman.

Governor, we certainly appreciate your testimony. I want to focus on one particular point here. On page 6 you said, "First, the focus * * * should be on benefiting farmers and their families." Skipping down the page: "We want to keep our farm families on their farms * * *." "* * * assistance should be specifically targeted to the preservation of existing farms." I agree with that 100 percent, and would like to explore with you just a bit more in detail what is going on out there in terms of foreclosures versus restructuring, and particularly within the Farm Credit System.

I have the feeling from my observations that the emphasis within the Farm Credit System in attempting to manage this problem has been almost entirely on the side of foreclosing and cashing in and eliminating problems in that manner, as opposed to restructuring of debt and trying to keep people on the farms. Would you care to comment on that at all?

Governor **Branstad**. Congressman, I think you're absolutely right. We have been pushing for sometime to try to get more done in the area of restructuring. We have had some help from commercial banks in this area but very little from the Farm Credit System. I am aware of instances in the State of Iowa where the Farm Credit System has foreclosed on a farm member of their system and, incidentally, the Federal land bank interest rate in Iowa is now 13.5 percent, plus you have to have 5 percent stock, which means the effective rate is over 14 percent. You can buy a car at 7.7 percent interest but the farmer has got to pay over 14 percent to the Farm Credit System.

Then they foreclose on that farmer, push him and his family off that farm, and will sell to an outside investor for 10 percent down and 10 percent interest. I think, it's a travesty that that is being permitted to happen, and the Farm Credit System is doing that. They are doing that in my State, in your State.

Mr. **Evans** of Iowa. Then would you agree with me that in any legislation that we pass dealing with the Farm Credit System, there ought to be strong—I'll use the word "incentives"—to encourage the Farm Credit System to restructure rather than to foreclose?

Governor **Branstad**. I think it's essential that strong incentives be in place because our goal should be not just to bail out the Farm Credit System. Our goal should be to help farmers and to be able to give them an opportunity to survive through this very difficult time. The Federal Government has helped Chrysler, Lockheed, New York City, and many others, when they went through a difficult time, to make the transition, and the farmers would like to have that same kind of an opportunity. I think it's important that whatever you do recognizes the need to assist the farmers and to retain the family-farm ownership wherever possible.

Mr. **Evans** of Iowa. Thank you, Governor.

I yield back my time, Mr. Chairman.

Mr. **Jones** of Tennessee. Thank you very much, Mr. Evans.

The Chair recognizes Mr. Thomas for 5 minutes for questioning.

Mr. **Thomas**. Thank you, Mr. Chairman.

Governor, let me thank you for coming here this morning and taking your time, and let me commend you for your very courageous action on the moratorium in your State. There are a lot of us up here who think that further foreclosures are really a senseless act at this time. I don't think they accomplish anything. We have found, however, that probably the will of the Congress is not such that it would sustain our action to provide broad moratoriums out of legislation here in Washington.

But I think you have hit the nail on the head. The longer we go ahead and continue this foreclosure pattern—and I am seeing the same thing in my own State of Georgia that you are seeing in Iowa, and that is that we are foreclosing and putting experienced farmers and now good farmers off the land, turning around and selling that same land, in many instances not requiring the purchaser even to purchase stock in the land bank, as I am being told.

Yesterday, in talking with Governor Wilkinson, I tried to get my concern across to him, that in this period here in which we are looking at the credit debacle, trying to decide what to do about farm credit itself and the whole credit program in agriculture, that prudent action, restrained action on their behalf in my opinion is certainly going to shape me as a Member of the Congress in my thinking as to what I am willing to do. To start with, I am not willing to step in and do something that affects only the farm credit service in itself. I just don't intend to do that. I think we have to look at the whole broad credit issue.

I just wanted to make that little statement there, but I wanted to ask you something. Seemingly, in trying to understand the situation across the country, in the southeast we are a little bit different. Our credit problem started back in the late seventies. We had made a tremendous investment in agriculture. At that time we were hit by a very severe drought, and so we experienced a washout over a period of time. We have lost a lot of our farmers already.

I seem to perceive that what has happened in places like Iowa, and really in the heart of the farming country, that everybody has been pushed to the edge all at one time, rather than that slow rate of attrition which we have experienced over a half a decade now. Would you assess that, that what has happened is that where your farming institution was much more stable, your production was higher, your cost of production cheaper—even though we know land probably got out of kilter due to inflation and other things, not the rampant speculation like David Stockman might have us believe—but would you assess that that is what has happened in Iowa? Am I accurate, that your farmers and creditors, the borrowers have been pushed to the edge all at one time, and what we are about to see is a sudden washout that is really going to be devastating to your State's economy?

Governor Branstad. That's correct. That's what is happening to a great degree. I would point out that some of the bad operators that David Stockman always liked to talk about basically were washed out 2 and 3 years ago in our State, so we have had people that have gone out of business. There's no question about it, and those people that were highly leveraged, they went out some time ago. The land has already dropped over 50 percent. We are now hitting 60, 65 percent in some areas of the State and, frankly, the best of operators, the people that were receiving awards and recognitions for being outstanding and progressive farmers, are the people that are now up against the wall and likely to be pushed out of agriculture.

That's what the situation is today, and not just them, but it's 20 percent of the businesses that depend on agriculture. There is hardly—in my home county I think there is one farm machinery dealer left. Six years ago I think we had six, and that's in my home county, Winnebago County in northern Iowa, and that's true all over the heartland of this country. So I think in the Midwest maybe it has hit us more at one time than it has in some other parts of the country but I suspect, in talking with Governors from other States and other parts of the country, that there are many States, there are many other regions of the country that are right behind us.

Mr. THOMAS. There has been some effort through the Farm Aid and others who have come here to Washington, some in informal hearings, to try to focus on the kind of pressure that the debacle in agriculture has brought to the family and to the fiber of rural America. I personally find it very real in my own State. I am beginning to see farmers unfortunately join in some organizations that I view as very radical and not the kind of organizations that I think are going to be constructive in this effort.

I know the kind of people that they are. I know where they come from. I know their background, and I know they are being driven to these organizations as a last, desperate sort of effort. I am concerned about the kind of violence. I am concerned about the mental attitude and the mental health of rural America at this time, and I think it's something that we are overlooking; but you share, apparently, from your comments, the same concern about the rural people in your area.

Governor BRANSTAD. I am very concerned. We started a year ago a "Rural Concerns Hot Line," an 800 toll-free number that people could call in, and the calls have been getting more and more desperate as the situation has gotten worse. In our State in the last 2 months we have had three suicides of farmers, not necessarily farmers that were on the brink of going out. They were people that had been successful, that just couldn't take what was happening.

It's a tragedy and it's hard for the people in my area to understand how Washington could be so oblivious to the catastrophe that is occurring in the heartland of this country and is occurring all over. You know, these are the hardworking, dedicated, patriotic sort of people that really are the ones that the President likes to talk about, that believe in traditional American values of hard work and ethics and religion and all that sort of thing. They are the kind of people that are really crying out for some hope, for some help, from both the Congress and the administration.

Mr. THOMAS. Thank you, Governor.

The CHAIRMAN. Will the gentleman yield, or the chairman, if he has run out of time?

Mr. JONES of Tennessee. Thank you, Mr. Thomas.

If it is agreeable to you, Mr. Gunderson, I would be glad to recognize the chairman of the full Agriculture Committee at this time.

The CHAIRMAN. Thank you, Mr. Chairman. I welcome the Governor. I apologize I wasn't here to receive you when you came in. I was detained elsewhere. The Governor and I have visited on this.

Governor, you continue your litany of "those people in Washington." Would you tell us what people in Washington you're speaking about?

Governor **Branstad**. Certainly the administration, and those people in the Congress—you know, I guess I would exclude this committee, because this committee——

The **Chairman**. Well, that's fine. [Laughter.]

Governor **Branstad**. I'll tell you why I exclude this committee. This committee had the guts to call these hearings and to let it be told like it is. There are a lot of people in this city that would like to ignore it and hope that it would go away, including Mr. David Stockman, who I had quite a confrontation with last year over this issue. He gave myself, our State superintendent of banking, Neil Harle, who is our expert on agricultural economics, his own lecture on economics. He was dead wrong. The administration has not responded. They need to respond. I hope that today they will respond, and frankly this is a problem that will continue to get worse until we have some action.

The **Chairman**. Thank you, Governor. As you know, our attempt long ago, as bad as people thought the legislation was, on emergency credit was vetoed by the President. I assume that's "the people in Washington" you speak about.

Governor **Branstad**. Well, we were very disappointed with that. We feel that this issue needed to be addressed. I was saying that last year. I frankly felt that the administration had indicated that they were going to provide some loan guarantees and help with restructuring of the agricultural debt, and then that restructuring was limited to only farm operating loans instead of farm ownership loans. Frankly, the issue has been stonewalled for too long.

The **Chairman**. It's so simple when you're out there to point the finger and say, "all those people in Washington," but now you have clarified your meaning. You don't mean us; you're speaking of other people in Washington, but you warn, in your statement, "There is no reason to eliminate the farmer-owned and farmer-controlled system." Now we know and it has been documented that the Governor of the Farm Credit Administration basically had no authority, that it was run solely by the local farm land bank and so on, so then if something failed, it failed down there because the man up here says he had no authority.

Governor **Branstad**. I just don't happen to agree with that. Frankly, the decisions have not all been made by the farmer members. In fact, I would submit that most of the decisions have been made by the professional staff that, incidentally, voted to give themselves a pay raise at the time that they are pushing farmers out of business.

The **Chairman**. Yes, that came at a very bad and odd moment, but who made the decisions whether to make the loan or not? Was it those people in Washington or was it your local banks or PAC's or——

Governor **Branstad**. I think there is plenty of blame to go around.

The **Chairman**. Well, it's not a question of blame but of documentation. We need to know what happened, to know what we need to do.

Governor **Branstad**. Well, I think those decisions were made at a number of levels, but clearly I think they were made from the full support from the top in the system. They wouldn't have been occurring if it hadn't been for the support and the encouragement that came from the management and the leadership in that system.

The CHAIRMAN. Every individual loan at every individual——

Governor BRANSTAD. Absolutely not. Those were made by individuals that were employed by the system.

The CHAIRMAN. The locally farmer-owned, farmer-investor system down there.

Governor BRANSTAD. The problem is, all kinds of decisions are being made without any kind of input from the farmer-owned system. Decisions are being made in my State that affect farmer members of the system, that farmers don't agree with and they are very strongly objecting to.

The CHAIRMAN. I'm glad to hear you say that, Governor. That's what I have been saying throughout these hearings, that we've got the wrong people testifying. Not you. [Laughter.]

We've got the wrong people testifying. The last few days we have had all of the administrators. We haven't had the people who are telling us something different than we are hearing up here.

Again, my pledge to you, Governor, is to work with you, with all the input that you can provide, but I would hope that you would be a little bit more specific when you point and say, "those people in Washington."

Governor BRANSTAD. Well, we appreciate those of you in Washington that understand and are working on this. I know from our contact and our discussions, Congressman, of your great concern and effort, and we appreciate it. Thank you.

The CHAIRMAN. We look forward to working with you, sir. Thank you.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Chairman de la Garza.

Now I yield 5 minutes to Mr. Gunderson.

Mr. GUNDERSON. Thank you, Mr. Chairman.

Governor, coming from the State of Wisconsin which is neighbor to you, I want to first welcome you on behalf of my sister and brother-in-law who are constituents of yours. Coming from Wisconsin, I want to suggest that we in Wisconsin would be much happier if Iowa would spend a little less money on Hawkeye football and a little bit more on your farmers. It would make our fall a little bit more pleasant. [Laughter.]

Governor BRANSTAD. I'll tell you I understand that the Badgers are still healing up from the ball game——

Mr. GUNDERSON. We haven't won any since.

Governor BRANSTAD [continuing]. But we didn't use any taxpayers' money to finance that football team. [Laughter.]

Mr. GUNDERSON. You have instituted, as you have explained, a moratorium in Iowa. We have wrestled with that same issue of a moratorium here at the national level, and many of us have suggested that perhaps a case-by-case review and analysis is more defensible. Have you taken any position on the need for a national moratorium in agricultural loans?

Governor BRANSTAD. Congressman, I am aware that Senator Grassley has proposed in the Senate—and I assume there are similar bills here in the House of Representatives—a moratorium of that sort. I would point out that the moratorium in Iowa is really a case-by-case situation. I have signed an executive order which makes the moratorium available but it is not self-executing. The individual farmer must go to court and ask a district court judge to grant a moratorium, so there is a finding of fact determined by the judge to determine whether that farmer is in fact entitled or eligible to a moratorium. I would suggest that something similar on a nationwide basis could be very helpful.

Frankly, many of the lending institutions have reacted very negatively to the moratorium but when you really probe and ask them, "Is this something you can live with," frankly they admit that most of them were doing it anyway on a voluntary basis, and this just forces the Farm Credit System and others that were not exercising forbearance in working with their farmer borrowers to do so, so I would certainly highly recommend that something similar be done on a nationwide basis.

Mr. GUNDERSON. One of the problems we had yesterday in our hearings, and I'm quite confident we'll have again today, is that a number of people are coming to the table and are suggesting that we institute comprehensive, financial-wide solutions—interest buy-downs, Capital Corporations to buy up all nonperforming loans, et cetera. The problem with all of those proposals is, they absolutely guarantee that whatever we do will be sent to the Banking Committee, and in my opinion that whatever we do will not become law. We are very limited in our jurisdiction in this subcommittee, really, at this point, to deal with the Farm Credit System.

I would ask you if you would be supportive if we do come out with some type of legislation that would really, one, give the Governor of the Farm Credit System more independent regulatory powers; that would allow the Farm Credit Administration the kind of flexibility they need internally to pool their resources; but, to also provide a Federal line of credit to the Farm Credit System. If we came up with a proposal that did those three things, we "wouldn't be dealing with the problem universally," in terms of interest buy-downs, et cetera, but it may be the best this subcommittee can do. Would you be supportive of that action?

Governor BRANSTAD. I would see that as a step, but certainly not to provide the kind of stability that I think is needed. You say it would have to then go to the Banking Committee if it went the other route. It might be that a combination of legislation—maybe this subcommittee could initiate something, and something else could be done—but frankly I feel the problem is bigger than that. It can't be handled just internally in the Farm Credit System. If we really want to stabilize the situation and prevent the hemorrhaging from worsening, I think it is going to have to be more comprehensive than that.

Certainly what you are discussing would be helpful. It would be an important step but I don't think it would be adequate by itself.

Mr. GUNDERSON. One final question which is really a similar question to what Chairman de la Garza asked, only it would be from a Republican perspective: A number of us sitting on this side of this table share some of your frustrations with our inabilities to get other people in this town to recognize the severity of the problem in the heartland.

I would ask, one, what the Republican Governors' Association is doing or, two, what you can suggest to fellow Republicans to try to bring this problem to the attention of others. I think when you hear the administration's testimony today on the Farm Credit System, you will be as disappointed as most of us are. We are also at wit's end, and if you've got any suggestions for us, I would be interested in hearing them.

Governor **Branstad**. I would encourage you, any time and every time you get the opportunity, to communicate directly with the President, with Don Regan. I am going to be meeting with Jim Baker this afternoon. I had an opportunity, along with other Republican Governors, to meet with the President 2 weeks ago. Frankly, I dominated a good share of the time we had in the White House just sharing with the President the hurt out in the heartland of this country in the area of the farm crisis.

I don't think there is a great enough awareness and understanding of that in the White House. I think that needs to be clearly and unequivocally communicated to the administration, and I think we've got to do everything we can to get that across. I have been a loyal Republican but I am also the Governor of an agricultural State in the heartland of this country that is being hurt by the unwillingness and insensitivity of this administration in terms of the problems that exist in the farm credit area. They need to be addressed. They are not going to go away by ignoring them, and that message needs to come across.

I hate to be the bearer of bad news. This President has provided tremendous hope to the people of this country and he has done much to give a resurgence to the national economy, but the agricultural heartland of this country has not shared in that resurgence, and he needs to provide some hope there. We need to get that message across. The President needs to sign the farm bill. The administration needs to support the efforts here in the Congress to deal with the farm credit issue.

That's the message that I would encourage the Republican Members of Congress, as well as the Democrats, to do. The problems are not partisan. The problems are real and they're human, and they need to be addressed in a sensitive way by both the administration and the Congress.

Mr. **Gunderson**. Thank you, Governor.

Thank you, Mr. Chairman.

Mr. **Jones** of Tennessee. Thank you very much, Mr. Gunderson.

Now I yield 5 minutes to Mr. Weaver, who was here earlier, had to leave, and is now back. Mr. Weaver.

Mr. **Weaver**. Thank you, Mr. Chairman.

Governor, I see the President's contribution to the well-being of our economy as a smile and a shoeshine. The root of the problem is the farmer's inability to pay back the loans because of low prices for the commodities he produces and sells. My position on this issue is that I strongly oppose any bailout of the Farm Credit System until and unless the farmer is given the means to increase his income so that he can make these loans substantial.

I am going to ask you how you can support a bailout of the Farm Credit System without any enhancement of the farmer's ability to pay back the loans? It doesn't do any good to bail out the banks when the borrower is still bereft. Would you comment?

Governor BRANSTAD. I don't think you listened to my testimony.

Mr. WEAVER. I wasn't here, sir, although I tried to read it as I went to the whip's meeting.

Governor BRANSTAD. I made it very, very clear that it would be wrong to bail out the Farm Credit System without providing direct assurance and assistance to the farmers and stabilizing the farmers. That is what our main concern ought to be—is to help the farmers to keep those farm families on the land.

I believe that the farm bill which the House of Representatives has already passed, which is now being debated in the Senate, will be an important element to provide some assurance that income levels for farmers will not continue to decline, that there will be some stability on into the future, and that with that stability and that income assurance there should also be some immediate help to avoid the massive foreclosure of thousands of farmers in this country.

Mr. WEAVER. Governor, forgive me for saying this, but that's nonsense. The farm bill that passed the House, as became clear in this committee, would actually decrease the income of the farmer by lowering the various support programs. Did you support the amendment by the Congressman from Iowa, Berkley Bedell, that would have allowed the farmer to manage his supply?

Governor BRANSTAD. Congressman, I have not followed all of the amendments, and just about every member of my delegation offered amendments to that bill. Frankly, I support all of them. I know they're all working for the farmer and I——

Mr. WEAVER. You don't know the Bedell amendment, the single most important amendment to the farm bill, one of the most heavily fought amendments, the one that would have affected Iowa farmers the most of any provision in the farm bill? You don't know that amendment?

Governor BRANSTAD. Congressman, I am aware of the numerous amendments that have been offered by our Congressmen, by our two Senators, and I know they are all working with me because we recognize there is a crisis in agriculture in this country. It needs to be addressed, and obviously I am supportive of the efforts by all of our congressional delegation to deal with it and to deal with it in an effective way, but I also recognize my responsibility not to interfere in the congressional processes here.

Mr. WEAVER. But you're doing that right now, sir. You're coming back here and suggesting things that this Congress do.

I have no further questions, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Weaver.

Now I yield to Mr. Stallings for questioning.

Mr. STALLINGS. Thank you, Mr. Chairman.

I appreciate your comments, Governor. In light of the administration's attitude and the limited ability this subcommittee has, the Governors are going to have to take a lot of the initiative themselves. You stated earlier that you were speaking for the Nation's

Governors. What are you, as Governors, doing and attempting throughout farm country?

Governor Branstad. We had a conference call of the subcommittee on this particular area, and I would refer in my testimony to—it's about in the middle—where I indicated those points that the Governors have agreed upon. It starts on page 6. We feel that the focus of Federal assistance should be to benefit farmers and their families, and that by so doing we help small business, we help the entire economy of rural America. We also believe that the preservation of existing farms should be a paramount consideration as you deal with this farm credit issue. We believe that it would be a mistake; we believe it would be costly, even wasteful, to venture to stabilize rural lenders if farmers are not made substantially stable. So we think that should be the thrust of the effort.

Individual Governors have taken action, as I have in Iowa with our mortgage moratorium, but we recognize that no individual State can solve a national problem. That's why I am here today, as Governor of a leading farm State and as chairman of the Agriculture Committee for the National Governors' Association, to say we need help and we need the Federal Government to provide the assistance to farmers that has been provided to others.

You know the litany of groups that have received help through a crisis and have come back stronger as a result of it. Chrysler, New York City, Lockheed, they all received help here and are now in a stronger and more stable position. Agriculture will come back, but we should not force thousands of farmers and families off the land in this crisis when we could prevent it from occurring by helping stabilize the situation. This body, the Congress of the United States, and the President are the people that can take that action, and that's why we're here.

Mr. Stallings. From your best guess, talking with your economists and your agriculture advisers, do you see next year as an improvement over this year, or do you see a continuation of this problem and, if so, until when?

Governor Branstad. Without action, I see the situation is going to get dramatically worse in the next year. On the other hand, if you pass a farm bill and if you pass a farm credit package that will provide some hope and stability, and force forbearance on the Farm Credit System, and force them not to liquidate and foreclose on thousands of farmers, I think the situation could begin to stabilize and in fact we could see 1986 improve. We are really at an important crossroad. The action you take between now and the Christmas recess could well determine whether 1986 is a year of hope or a year of despair.

Mr. Stallings. Thank you, Mr. Chairman.

Mr. Jones of Tennessee. Thank you very much, Mr. Stallings.

The Chair recognizes Mr. Franklin for 5 minutes.

Mr. Franklin. No questions.

Mr. Jones of Tennessee. Thank you, Mr. Franklin.

The Chair recognizes Mr. Morrison for 5 minutes.

Mr. Morrison. No questions.

Mr. Jones of Tennessee. Thank you, Mr. Morrison.

We have several visitors with us this morning, some members of the full Agriculture Committee that I would like to recognize at this time. Mr. Penny from the State of Minnesota is here. Tim, we are delighted that you are here, and hope that you can stay with us today. Virginia Smith from the State of Nebraska, who is not a member of the Agriculture Committee but very interested in the problems that we have, and we are delighted that you are here. Any other Members of Congress who are here, we would be delighted if you would come and sit with the subcommittee.

Governor, I have a question or two that I just want to--does any other member of the subcommittee have a question before I ask mine?

[No response.]

Mr. JONES of Tennessee. I'm not going to take much time. You've been under the gun for a good while now and we have many more witnesses to hear today, but yours has been one of great importance. We watch what you do an awful lot. I congratulate your great State for having the ability to provide you, as an executive, with the ability to declare a moratorium on loan closings in your State. I wish more States had that.

What I would like to know is, for the record—and both Mr. Gunderson and Mr. Coleman and some of the other members did cover this to some extent, but just for the sake of the record—I want to know if the commercial lenders as well as the Farm Credit System lenders and others who are covered in the moratorium are receiving it with a good attitude? What sort of a situation are we in today? You should have had it long enough to know what the situation is.

Governor BRANSTAD. The initial reaction from the commercial lenders was negative. However, now——

Mr. JONES of Tennessee. Tell me who the commercial lenders all are.

Governor BRANSTAD. Well, we're talking about independent bankers and the bank holding companies and those people. Their initial reaction from their leadership was negative. However, after reviewing our law—remember this, it's limited to farm real estate mortgages that are in the process of foreclosure, and it's not self-executing. Frankly, what it does is, it changes the burden of proof to the lender to show that they have exercised forbearance, that they have tried to restructure the debt, and those sorts of things that Congressman Evans pointed out in his questioning. It forces the lending institutions to do that, and to work with the farmer first, and only to use foreclosure as an absolute last resort.

Those that abide by that, and most of our commercial lenders have abided by it, have found out it's not something that they can't live with. They didn't particularly like it. Philosophically they were opposed to it, but they have accepted it, they are living with it, and it's working. I hope that the Farm Credit System will continue to abide by it, and frankly I think they should back off their effort to circumvent it. If they don't, we'll be fighting it out with them in court, but so far they have all abided by it.

Mr. JONES of Tennessee. So far the Farm Credit System has abided by the moratorium altogether?

Governor BRANSTAD. So far they have, but the rumor is that they have an emergency rule that they are going to publish in the Federal Register in an effort to circumvent the moratorium. Now that is despite what the Omaha district said after the moratorium was put in place, that they would live by it and that they could live by it. We think that they should withdraw their effort to circumvent it. If they don't, we are ready to deal with them in court but I feel very important that the Farm Credit System was where the biggest problem is today. That's where the largest potential for massive foreclosures exists, and they need to abide by that moratorium. Frankly, their mortgages are based on State law and we feel confident that legally they have an obligation to abide by it.

Mr. JONES of Tennessee. One other question, Governor, on that same line. Do you feel that a moratorium would be appropriate for the entire country at this time?

Governor BRANSTAD. I believe that a limited moratorium, along the lines of what we have in Iowa, would be an appropriate measure. I believe that it could help force forbearance. It would force the lenders to work with the farmers, as opposed to just trying to save their own system, to actually look at it with a realization of the need to help farmers that, with some assistance and through some restructuring of their debt, could survive through this crisis period.

Mr. JONES of Tennessee. Thank you, sir.

One other thing I want to comment on—I don't necessarily need an answer but I do want to mention this—the chairman did mention the fact that he was not clear as to whom you were speaking of in Washington who might be derelict as far as what they were doing in this regard was concerned, as far as our problem goes. I'm glad that you made—and quoting from a former past President who made the statement famous—I'm glad that you made it perfectly clear that you excluded this subcommittee. [Laughter.]

Governor BRANSTAD. Thank you. Congressman Jones, I very much appreciate your leadership on this very important issue to this country.

Mr. JONES of Tennessee. Well, let me say that we appreciate the members of this subcommittee and the full Agriculture Committee that the State of Iowa sends to this House of Representatives. Thank you very much.

Governor BRANSTAD. Thank you.

The CHAIRMAN. Mr. Chairman, would the chairman yield?

Mr. JONES of Tennessee. I would be glad to yield to the chairman at any time.

The CHAIRMAN. Just a followup to the Governor. We visited about it. Do you have any numbers about how your moratorium is working, Governor? Have you compiled any numbers about how many farmers have availed themselves and how many were successful?

Governor BRANSTAD. It has just begun, and you need to know that first of all the farmer has to be actually filed with a notice of foreclosure——

The CHAIRMAN. Right.

Governor BRANSTAD. So if the moratorium prevents the Farm Credit System or a commercial lender from ever filing that notice of foreclosure, we don't know how many there are like that. We suspect there are hundreds. We know that there are instances of cases presently pending where a mortgage foreclosure was in process and the farmer has gone in and asked for a moratorium.

I know of one case where the judge has already granted a moratorium. I know of other cases that are presently pending, but we expect that much more significant than the number that are going to be directly using it are the ones that are prevented from moving forward because they now realize the burden of proof has been shifted. They can't merely go in and foreclose. They are going to have to show that they have utilized all resources available from the State and Federal Government, they have tried to restructure the debt, and that the farmer wasn't current on interest. All of those things have to be shown by the lending institution to avoid the imposition of the moratorium by a district court judge.

The CHAIRMAN. Thank you. My concern is that we use the word moratorium too loosely, and of course it would be very difficult to decipher if it is preventive and keeps them from foreclosing, but we also don't want to give false hope or give a misrepresentation and allow people—because you asked that we give them hope but we have to give them hope that is accurate and positive.

Governor BRANSTAD. Congressman, you make a good point. I have tried to point out that all the moratorium does is, it buys some time. The hope has got to be provided by action you take on the farm bill and on the farm credit issue here in Congress. We in the States cannot provide that hope by ourselves. We can merely buy some time through this moratorium. It doesn't solve the problem. We really are here today for the purpose that we recognize that the solution has to come out of Washington.

The CHAIRMAN. Well, we thank you. I personally, speaking for myself, commend you for your courage in taking the action you have. We appreciate your cooperation and we pledge our cooperation to work with you and with all of the Governors and attorneys general, all of the State officials who work with us in a positive manner, outside of rhetoric and outside of shouting at the cameras, but working diligently to do what needs to be done. We thank you, Governor.

Governor BRANSTAD. Thank you.

Mr. JONES of Tennessee. I thank the chairman.

I am going to recognize Mr. Glickman for just a moment. He has just arrived, and he has a question, Governor.

Mr. GLICKMAN. Thank you.

Sorry, Governor, that I wasn't here during your statement.

Senator Boschwitz has proposed a plan whereby the States would participate with the Federal Government in an interest buy-down proposal, whereby the Feds would agree to basically 2 percent, some sort of subsidy, where loan interest rates would be reduced by 2 percent if the banks would participate, if the State governments would also participate. Have you given any comment on a proposal whereby the States would be actively involved in an interest buy-down proposal, either on your own or in connection with a Federal proposal?

Governor BRANSTAD. Yes, that has been discussed or considered. Our problem, which is not different from a lot of other States in the heartland, is the State is in trouble financially due to the farm problem. I just cut State spending across-the-board by $91 million—

3.85 percent—so the State does not have a surplus that we can go out and spend for this but, frankly, if Senator Boschwitz' proposal were to be approved, I think we would do our darnedest to try to find some way for the State to participate in that kind of an effort.

We don't have the money and I can't at this point tell you how we would come up with it, but I think it's an important enough problem that if, in fact, the Federal Government and the lenders participated, that our State would do its level best to try to find some way, even though we are not in a financial position to do so, to be involved, because we recognize that this is something that we need to address and we want to do our part.

Mr. EVANS of Iowa. Will the gentleman yield briefly to me?

Mr. GLICKMAN. Well, I don't want to lose my time but I will yield briefly.

Mr. EVANS of Iowa. I would just say that I think that, under Senator Boschwitz' final version, participation by the States was left voluntary to accommodate that need.

Mr. GLICKMAN. One final question: As you know, we have passed H.R. 2100, which provided basically for your freeze and target prices. Yesterday the Senate defeated by 3 votes a proposal by Senator Lugar, sponsored by the administration, to freeze target prices for 1 year and then begin a 5-percent reduction in target prices every year for the next 3 years. Both your Senators, I believe, voted against that proposal. I wonder if you might give us, from your perspective as a Governor, how you feel about that particular proposal, the administration's proposal to cut target prices over the next 4 years?

Governor BRANSTAD. From the very onset I have indicated that I think that's a very disastrous proposal that would pull the rug out from under farmers, that would not provide the sort of income assurance and stability that we need, and I have actively opposed it. I am proud of the fact that our entire congressional delegation, both in the House and the Senate, has also taken that position, and on a bipartisan basis the Iowa delegation and the Governor of Iowa stand together in recognition of the need to provide income stability for farmers, and that we should not be phasing out the target prices at this time.

Mr. GLICKMAN. If that position were to be implemented in law—that is, the reduction in target prices as the President has proposed—what do you think the impact would be on Iowa farmers?

Governor BRANSTAD. The same we have got today, despair, and the situation would be viewed as going to continue to get worse. What we need is just the opposite. We need a farm bill that will provide income protection, retain the target price system, and deal with the farm credit problem in a way that would provide some hope and some opportunity that things would not get worse, but would be likely to get better in the future.

Mr. GLICKMAN. Thank you, Governor.

Mr. JONES of Tennessee. Thank you very much, Mr. Glickman.

I want to recognize Mr. Huckaby, who is also a member of the full committee, who just arrived. Jerry, we appreciate your being here.

The subcommittee is going to stand in recess until the hour of 10:30, now, until we go take a vote, inasmuch as the next witness should be heard by all members of the subcommittee. We are in recess.

[Recess taken.]

Mr. JONES of Tennessee. The subcommittee will resume its sitting.

Our next witness is the Honorable Frank Naylor, Under Secretary for Small Community and Rural Development with the U.S. Department of Agriculture here in Washington. Frank has been here on numerous occasions. This subcommittee is not new to him and he is not new to the committee. We know each other rather intimately.

Frank, we are delighted that you are here today.

You may go, Frank.

STATEMENT OF FRANK W. NAYLOR, JR., UNDER SECRETARY, SMALL COMMUNITY AND RURAL DEVELOPMENT, U.S. DEPARTMENT OF AGRICULTURE

Mr. NAYLOR. Thank you, Mr. Chairman.

Mr. Chairman, before we commence here I would like to take this opportunity to commend you on your exceptional leadership in behalf of the House of Representatives and the House Agriculture Committee, and our close working relationship with you and Mr. Coleman and others of your subcommittee in evaluating and recommending on how to deal with this exceedingly complex and serious problem which we must resolve as quickly as possible. And we must resolve it in a well thought through and carefully developed process of cooperation between the Congress, the administration, and the Farm Credit System. I think your leadership in that area has been particularly outstanding in helping us to get that kind of support, and I thank you for it, along with Mr. Coleman and others who have worked so diligently, as we continue to proceed in that effort in the weeks ahead.

I think all of us feel very strongly that this is a particularly complex issue, one that does not have easy solutions, but which must be solved. It is an issue that does not lend itself—and should not, in our view—to a partisan solution, but rather a bipartisan and cooperative effort between the executive branch and the Congress to, as quickly as we can, find the means to effectively stabilize this system.

Mr. Chairman, I have provided the subcommittee with a summary of the administration's position, and with your permission would like to ask that it be entered in the record. I am prepared, with your permission, to summarize the assessment of the administration on the status of the system and our recommendations for the subcommittee.

Mr. JONES of Tennessee. Without objection, it will become a part of the record, the full text will be, and then you may summarize as you please.

Mr. NAYLOR. Thank you, Mr. Chairman.

Mr. Chairman, the administration is in the process of evaluating the current operating conditions, strengths, and weaknesses of the cooperative Farm Credit System. This is an ongoing and intensive process on an administrationwide basis—including the Department of Treasury, other financial and economic officials within the administration, and the Department of Agriculture—and has been perhaps one of the most extensive reviews that I have seen done in the executive branch on any subject in the time that I have had the opportunity to serve in Washington. We have had frequent consultations with Members of Congress, including yourself, and more particularly with the system, their operating officers, represented by the Farm Credit Council here in Washington, and with the Governor's Office of the Farm Credit Administration. They have been fully cooperative with the administration in our effort to determine their situation.

We would say at the outset that indeed they are faced with a very serious problem. Through the fourth quarter of this year they will undoubtedly report $2.5 billion more potential loan losses in 1985, another $1.5 billion in 1986, and $1.5 billion in 1987, for a total of potential but not yet realized losses, of perhaps $6 billion. This indeed is a very serious situation which must be dealt with.

But, I think, it is also important to understand that we are dealing with a financial institution with a very significant amount of operating strength. FCS has one of the strongest capital bases of any financial institution in America. It has, as of September 30, $1.6 billion in loss reserves, and is quickly adding to these reserves to adequately protect themselves over the next 2 to 3 years into the future. It has $5.5 billion of earned surplus, and it has $5.3 billion in assets in the form of borrower stock.

The problem for the operating system, however, is that it has been unable to mobilize those resources because of its highly decentralized structure, and that inability has severely affected its capacity to adequately assist those most stressed areas.

There has also been considerable uncertainty in the bond markets and security areas, because the system itself has been unable to identify the extent of its loan losses and to determine its own ability to coordinate its resources to recoup and deal with those losses. As a result, in the last 60 days, the system has indeed been faced with paying a premium in the securities market because that uncertainty, which has been put on the table by the system, has clearly been there. Farm credit must be able to finance itself and have access to the market in order to remain the key source of credit to agriculture that it is important for it to be.

Finally, in addressing the basic underlying problems that lead to the summary which we have provided for you, the Farm Credit Administration itself has lacked the authority and enforcement powers to properly, on an arm's-length basis, provide the independent regulatory authority needed to ensure the safety and soundness of this financial institution. That has been a major detriment to attempts to thwart the problems that have been developing.

The result of this, Mr. Chairman, particularly in the heavily stressed areas of the Midwest, is that farmers in districts under particular stress are having their interest rates increased, and having their stock placed at risk. Policies on adequately and fairly restructuring problem loans are a serious problem to them because of the lack of access to the overall system strength and available resources.

With that as the background of the problem, Mr. Chairman, I think it is important for us to say that the administration recognizes the vital role that the Farm Credit System plays for the Nation's farmers. We believe firmly that the Farm Credit System should remain a privately owned organization, sensitive to the market forces; and more importantly, to the needs of its members, the American farmers. The Farm Credit System needs to remain a viable lender of agricultural credit in this country, to serve farmers at reasonable and fair rates, and it is our belief that this system should remain an agricultural cooperative type of operation.

Mr. Chairman, in preparing the recommendations which we have provided to the subcommittee, Secretary Block and the Department staff have applied three tests that we believe are appropriate for Congress and ourselves to apply. We must remember that our fundamental concern is the health and welfare of our farmers and ranchers of this country.

The tests that we have applied simply are these: first, to see that farmers continue to be able to obtain credit from the Farm Credit System at reasonable rates, competitive rates, to meet their credit needs. Second, to provide the capacity for the system to manage problem loans in a way that is fair and reasonable and prudent both to the system and to the farmers which they serve--to restructure, to readjust, to carry, as appropriate, outstanding loans, but do that in a prudent fashion. And, finally, to safeguard and reasonably ensure the stability of the stock and investment of individual farmers.

In making those assessments, and taking into account that systems in the financial community prefer to help themselves wherever possible, the Government has rejected the notion of direct Government support included in some of the proposals we have seen earlier. The impact and effect it would have would be to spur demands from others seeking equal treatment under this notion of funds up front, if you would. As long as the system can borrow and have access to the system at reasonable rates, the system can indeed remain a viable lender and remain able to meet the needs of farmers. It is crucially important that the market perception be that this is a viable lending operation, soundly managed, properly regulated.

To make it through the years of losses—and the system will indeed be reporting record losses over the next 3 years—three basic changes are necessary. First, the Farm Credit System has to have the capability to mobilize its earned surplus under appropriate supervision, so that borrowers will know that their stock is cushioned by systemwide resources. It will provide more orderly restructuring of loans and provide greater discretion, particularly in the most distressed districts, to assist borrowers where prudent and possible. Association liquidation should be avoided, and the local control and decisionmaking process should be sustained.

Second, the Farm Credit Administration itself must be reorganized and reformed so it can operate as an independent, arm's-length regulator.

And, finally, the debt markets need to be reassured that indeed we do have a viable lending institution.

Mr. Chairman, the recommendations of the administration address all three of those issues. They address them first by creating an internal authority with the Farm Credit System entity that is currently in place. They would mobilize the system's earned surplus in order to absorb operating loss and effectively help farmers in managing troubled loans.

Second, we have proposed to restructure the Farm Credit Administration to be a true arm's-length financial regulator whose authorities would include matters of entry and exit, safety and soundness, and protection and enforcement of sound financial operations.

Finally, Mr. Chairman, it is our belief that the administration and Congress can and will work together effectively with the system on this issue. In working with Congress, we can develop the willingness to deal with both the self-help changes which will enable the Farm Credit System to tap its own considerable resources, and to take on and agree upon the necessary reforms to the Farm Credit Administration as an independent regulator. The administration will then assess the need for Federal financial assistance and work with the Congress in developing a final adequate solution to the problem with which we are faced. We believe this approach is a sound one because of the complexity of the issue and the need to know effectively how best to marshal and deal with the problems the system faces.

Mr. Chairman, I would say in closing, before taking questions, that I think that we need to understand the system's current capacity to handle the problem and what led to some of the recommendations which I think you have earlier heard. The system does have sufficient earned surplus and earnings to deal with the problems they face over the next several years.

Using their own numbers and data, the system—using only earned surplus, not dipping into members' stock but earned surplus—can manage the projected loan losses they have and still drop only a little bit below the $1 billion level in their earned surplus account before returning to profitability in 1988, a year beyond the projections which they have provided. This is particularly true if appropriate reassurances are provided to the market and they can obtain their funds at competitive rates. I think that was evident from the impact in the market yesterday.

Finally, in the system's recommendations, you are seeing in effect, their assessment of their ability to cope with the situation. What we are really talking about Mr. Chairman, is an assessment of what kind of cushion or protective range might be appropriate, and that's a judgment call by and large. It reflects a belief in the degree to which the Farm Credit System can be effectively leveraged.

Currently it is one of the strongest financial institutions in the country. It has a leverage ratio of 8 to 1. In the case of Fannie Mae that ratio is 70 to 1, and the Fannie Mae group currently borrows at a lower rate than the Farm Credit System does because of the implied—as it does exist in the case of the Farm Credit System—the implied Federal backing.

Much of their assumption is based on how much leveraging they can carry out and to what degree they can access existing surplus efficiently. Indeed, legislation may be necessary to give them the tools—and we believe it will be—to accomplish that. We must give them the method and authority to effectively help farmers and ranchers through an extremely difficult period, which we believe firmly must be done to keep them as a viable lender.

With that, Mr. Chairman, I tried to expand a little bit on the background thinking that led to the summary which we have provided you, which outlines the most critical points for the members. I appreciate the opportunity to make these observations with you. We stand ready to work with your subcommittee and the House Agriculture Committee and the system. We believe that this should be in the form of an ongoing dialog at your call, working with you very carefully to develop an appropriate solution to reinstitute and reassure and strengthen the system, so that it continues to be the viable supplier of credit which we believe it must be.

[The prepared statement of Mr. Naylor appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Frank, for the statement and for the summary. Now we will take the liberty of allowing the subcommittee members to project questions to you.

The Chair yields to Mr. Coleman 5 minutes for questioning.

Mr. COLEMAN. Thank you, Mr. Chairman.

Yesterday the Farm Credit Administration said that they felt a reasonable timeframe to honor their request would be by the end of this year. How do you see the sequences developing with your proposal today, wherein you have asked us to provide some of the regulatory changes but did not deal in specifics with the financial assistance aspect?

Mr. NAYLOR. Mr. Coleman, it would be my hope that we would work on a coordinated, bipartisan basis, with the committee and the administration and the system, to develop the first two components. On that basis we would come to some agreement as to their acceptability with the Congress. The administration will at that point assess the Federal assistance need in question. It would be my hope that we would work toward a solution during the remainder of this calendar year.

Mr. COLEMAN. You mentioned that you would assume that things would be all right as long as the system was able to raise capital on Wall Street in a reasonable interest rate. Would you care to give us some guidelines as to what you might think reasonable rates would be, and if those were hit we would know that something was wrong?

Mr. NAYLOR. Mr. Coleman, our assumption is based on the maintenance of the historical spread between the Farm Credit System and the Treasury, which is 15 to 30 basis points.

Mr. COLEMAN. And yesterday I think it was 85.

Mr. NAYLOR. Yes; there was a substantial anticipatory—anticipating the administration and Congress dealing with this issue—reaction, which I think highlights the importance of the implied standing of the Government behind agency-status agencies. I think that's an important distinction which the system has not always fully appreciated. That has been a key factor, rather than simply the availability of their earned surplus, behind those securities.

Mr. COLEMAN. Well, the articles that were written in the press, that appeared in the press yesterday, reflected a possible assistance package with a specific figure on it. I wonder if your statement, if it had been made 2 days earlier, would have sent the same signals and we would have gotten the same spread yesterday? In other words, I wonder if you aren't sending a weaker signal today to those markets as a result of still not being able to provide us with a definite amount of assistance that the administration feels might be warranted?

Mr. NAYLOR. I would hope not, Mr. Coleman. I think our commitment to work with the Congress and the system to develop a solution, the need to work with them and the need to reassure the market, to develop a sound plan for them, are the key issues on dealing with their problems. I think until we have a firm understanding of what Congress and the administration want with regard to the specifics of the first two key issues, it is very difficult to predict what kind or how much, if any, financial assistance is needed. We will be in a much better position to work with you productively on that basis.

Mr. COLEMAN. Well, as I pointed out yesterday, it was only 2 weeks ago that privately we were being told by the system that they needed $10 billion in a line of credit. Yesterday it was unveiled at $5 billion, and it was suggested that we might wait 2 more weeks and find it be less but I'm not too hopeful. Could you tell me if there is a difference, a distinction, between a line of credit and a revolving fund, and if that is of any significance?

Mr. NAYLOR. Not really, Mr. Coleman. It's a matter of semantics and approach, but basically it is a function of the Federal Government's involvement with its agency-status agencies similar to Fannie Mae or FDIC, for example.

Mr. COLEMAN. Under the worst case scenario—let's say that the Farm Credit System were to go insolvent and collapsed—would the commercial lenders of this Nation and the Farmers Home Administration be able to provide credit for this next year in sufficient quantities to be able to meet that type of demand?

Mr. NAYLOR. Mr. Coleman, first of all I would observe that I don't see any probability or likelihood that that would occur. The Farm Credit System has enormous financial strengths it has not tapped yet. There is no reason to believe that they are anywhere near or about to be insolvent.

With regard to your specific question, it would be extremely difficult to make that kind of transition without the Farm Credit System there. It is doable but it is our belief that we need to act to ensure that the Farm Credit System remains the viable, major supplier of credit that it is.

Mr. COLEMAN. Thank you.

Mr. JONES of Tennessee. Thank you very much, Mr. Coleman, for your questions.

Now the Chair yields to Mr. Weaver for 5 minutes.

Mr. WEAVER. Thank you, Mr. Chairman.

Mr. Secretary, yesterday I asked most of the financial people—including Mr. Swackhamer, Mr. Tucker, Mr. Roll—what was the most important single thing that a banker looks at when reviewing a new loan, evaluating a new loan, and what is the single most important thing the banker looks at when seeing whether his loan is any good or not. The answer was the ability of the borrower to pay back. Would you agree with them that that's the most important thing, the ability of the borrower to pay back?

Mr. **Naylor**. That is the fundamental underlying concept of financial lending, Mr. Weaver.

Mr. **Weaver**. Thank you, Mr. Secretary.

There is nothing in your proposal today, nothing in your words here today, that in any way, shape, or form would help the farmer himself to become solvent enough to pay back the loans, so therefore the shoals on which the Farm Credit System is caught up is still there. A bailout would not help them. The thing to do is help the farmer. My position is that there will be no bailout, as far as I can do anything about it, until the farmer himself is put in a position to pay back the loans.

Your suggestion, your proposal, includes this new, fancy corporation, the Farm Credit Systems Capital Corporation. Is that not correct, that you lean pretty heavily on this new corporation that has been set up?

Mr. **Naylor**. It anticipates that this is the best vehicle to use to assist the system in pooling its resources and making them available to those units most distressed; yes, sir.

Mr. **Weaver**. They are going to pick these resources, with this new corporation, somehow out of the air.

Mr. **Naylor**. No.

Mr. **Weaver**. I don't see where else they are going to get them, Mr. Secretary. You haven't told us any way they can. It seems to me it's a fiction, this—what is it?—Farm Credit Systems Capital Corporation, FCSCC. I have made an acronym out of that, "farce," and to nail down the farce it is your testimony, calling the Farm Credit System—I believe this is a quote you just gave a minute or two ago to Mr. Coleman—"one of the strongest financial institutions in the country." Did you just say that?

Mr. **Naylor**. Yes, sir, and that's an accurate statement.

Mr. **Weaver**. That's an accurate statement? We had testimony from the Governor of the Farm Credit System regulatory agency that they had 18 days left before they would go bankrupt, if they couldn't sell their paper, and they came here saying that they were in desperate need of billions of dollars immediately—they couldn't wait until next year—immediately to bail them out. Let me tell you, Mr. Secretary, if that's the strongest institution in our country, we really have a fleet of Titanics out there, because the rest of them would be therefore in even worse shape.

How you can say that the operating system continues to have a very strong financial balance sheet when testimony yesterday was that much of the farmland has fallen 50 percent in value, and the farmland is the basis, the underlying basis of collateral for those loans, is it not?

Mr. **Naylor**. For a significant portion of them but certainly not to that level.

Mr. **Weaver**. And we can't say much about farm income, which is projected to fall to $25 billion next year, so we've got to look to the collateral. And if the collateral has fallen 50 percent in value, and under questioning—astute questioning, I might add, by the gentleman from Missouri, Mr. Coleman—they said it was continuing—the collateral, the land value—continuing to fall sharply, don't you start to get some whim-wham's in your stomach?

Mr. **Naylor**. Mr. Weaver, the system has indeed done just exactly what you propose, and that is to project—looking at all the factors you have asked me about here—their potential—I emphasize potential—losses over the next 3 years. They have concluded, and we think reasonably so, that those might amount to $6 billion. The system currently has $12.4 billion of assets, and it indeed is one of the strongest, particularly when you consider that it is an agency-status financial institution, one of the strongest in the country. If you compare it to Fannie Mae, the leverage ratio of the Farm Credit System is approximately 8 to 1. The leverage ratio of Fannie Mae is 70 to 1, and yet it enjoys a very favorable and strong position in the financial markets, in it's ability to sell its securities at competitive rates.

Mr. **Weaver**. Well, Mr. Smeal, who was here yesterday from Goldman Sachs, said he was bailing out of Farm Credit System bonds. If he is here today to listen to you, he'll probably bailout of Fannie Mae's as well. [Laughter.]

Mr. Chairman, if it's possible—I know we have a time constriction—if it's possible to have maybe a minute more after the round, I would appreciate it.

Mr. **Jones** of Tennessee. Thank you very much, Mr. Weaver. We will give everybody the second round if they so desire.

Now I recognize Mr. Glickman for 5 minutes.

Mr. **Glickman**. Frankly, after listening to you and reading your summary, I think this is a pretty namby-pamby statement. I don't think there is any sense of urgency in what you have said. Maybe you are trying to calm the marketplace, but I want to read one section of your summary.

You say: "If Congress is willing to legislate, one, the self-help changes and, two, the reform of FCA into an independent supervisor, the administration will assess the need for Federal financial assistance." I mean, that's a totally illusory statement. Are you or are you not going to provide Federal financial assistance? If you are, when? Do you need legislation to do it?

I mean, I think that we need to know, Frank, specifically what this administration is willing to do. You are putting up a lot of—jumping across a lot of hurdles before we get to that point. We need to know, what is your position? Are you going to support Federal financial assistance, and how much?

Mr. **Naylor**. Mr. Glickman, I think the way we have approached this is the only reasonable way we can, and that is to say that we do indeed need to agree upon the form of revamping the system so it can help itself, before we can effectively assess the need for Federal financial assistance. Now I don't think that's way in the future. We are all talking about as quickly as possible, an effort on all of our parts to deal with this very serious problem. Indeed, we would like to see it resolved by the end of the calendar year, which I think is important to restore confidence and ensure that adequate credit is available next year.

Mr. **Glickman**. But, Frank, we've got 60 calendar days and less than 20 legislative days left, and we have the Christmas holidays and the Thanksgiving holidays, and the Senate is wrangling over a farm bill and we have to go to conference over a farm bill, and half the people say we shouldn't do anything until the farm bill is completed. If we need legislation to straighten up this system, we've got to move now, not December 20. Frankly, to do that we need your guidance specifically on what you want to see.

Now you have said that we want to see the self-help changes and the FCA reform. We're going to do that. I can tell you that right now. There is no argument about that. The FCA has said that; so have the banks said that. So, given that, then, I think, it is incumbent upon you to tell us what specifically you need and what legislative authority you need to do it. I don't think you ought to keep this thing stringing all of us along, particularly because of what it's doing out there to interest rates and what it's going to do to land values, unless there is some reasonably quick guidance on the part of the administration. I am just saying, Frank, you have not provided any specific guidance today and I think you owe that to us.

Mr. Naylor. Mr. Glickman, we have been meeting regularly with the Farm Credit Administration, and the operating system, and we are getting very close—within the next few days—of having worked out an agreement on the principal components of the first two tenets that we have been talking about. I hope, and I know the chairman has worked and we have visited frequently, that we can sit down and work with the members in whatever forum he deems appropriate, to see if indeed we do have a basis for an agreement, so that we can make that necessary assessment and take that next step. I commit to you that my office and the offices of others involved in the administration are prepared to take whatever time and effort it requires to do that.

Mr. Glickman. Well, one thing, you have said today, at least on two occasions, you have said that these securities have the implied backing of the Federal Government. That means, therefore, that if push comes to shove, this administration will stand behind the rescue of the Farm Credit System. Is that correct?

Mr. Naylor. I didn't quite say that, Mr. Glickman. I said the basis of all agency status, whether it's Fannie Mae, Sallie May, or whatever, has long been that an agency-status agency has—that their ability to sell securities at essentially Treasury rates or very close to it is the implied Federal backing. Indeed, we are sitting here discussing that very issue today.

Mr. Glickman. What does implied Federal backing mean?

Mr. Naylor. Precisely that, that if there is——

Mr. Glickman. I'm not trying—I just want to figure out where you are.

Mr. Naylor. I understand, and I'm not in a position to specifically answer that question because we've got a couple of things that we need to work out, and we are prepared to do so. Then we are prepared to work with the members and with the system. We want this problem resolved. This isn't a partisan issue. We need this system functioning effectively to respond to farmer needs, and we are going to work with you to get that done in a reasonable fashion.

Mr. Glickman. Well, we hope so. We have had some time to look at the problem. We don't have very much time left before the end of this year. We are ready to move but it is incumbent upon the administration to bring down a specific legislative proposal.

One final point, Mr. Chairman.

One point that you state in your statement is that restructuring the Farm Credit Administration into a true arm's-length financial regulator. You call for that in your statement.

Mr. NAYLOR. Yes, we do.

Mr. GLICKMAN. I just think it's an important point to know that, in this era of deregulation, that what you are calling for here, which I agree with, is the recognition that when it comes to regulating financial institutions, that deregulation as a purist concept just doesn't work. By your statement, I take it as an acknowledgement that, at least in this case, deregulation is not a very good idea.

Mr. NAYLOR. Clearly we need a regulatory body that is indeed that, and is not involved in other unrelated activities in a general management and policy setting, which makes it impossible for them to maintain that arm's-length objectivity that is necessary to provide for safe and sound financial operation.

Mr. GLICKMAN. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Glickman. The Chair recognizes Mr. Gunderson for 5 minutes.

Mr. GUNDERSON. Thank you, Mr. Chairman, and Mr. Secretary for your opening statement.

Explain to me why the administration cannot say today, "Providing that Congress establishes the independent regulatory arm and provides the necessary legislative mechanism for internal changes within the system, we will do what is necessary to stand behind the Farm Credit System." Why can't you make that statement today?

Mr. NAYLOR. Mr. Gunderson, our problem simply is this. While that is a broad, general, fairly easy statement, the technical side of it makes a big difference. For example, having the authority and the ability to pool and effectively use current surpluses makes a big difference in their capacity to deal with the problem themselves and what kind of Federal assistance, if any, is appropriate. We need to complete that closure by determining how to best give the system the necessary authorities to do its job, so we can make specific recommendations to the Members of Congress and to the Senate.

Mr. GUNDERSON. Are you saying to us that we must pass legislation which achieves points one and two before you will consider any kind of commitment for assistance?

Mr. NAYLOR. No, sir; no, I am not. I am implying, I hope quite clearly, that we are prepared to work very closely out of the executive branch with Congress to develop a solution.

Mr. GUNDERSON. When will we know the specifics of what the administration finds acceptable in terms of points one and two?

Mr. NAYLOR. We should be essentially completed working with the Farm Credit Administration and others in the system on those principal points by the end of next week, Mr. Gunderson.

Mr. GUNDERSON. At that point will your recommendations be absolute, or will you still be flexible in working with this subcommittee?

Mr. NAYLOR. I think we need to be flexible in working with the subcommittee. We are prepared to review our recommendations with the committee, informally or formally, as the chairman may desire, in any arrangement that is convenient to you and similarly with the Senate. We will answer questions both from the administration and from the system itself that I'm sure you will have with regard to many of those provisions. We will see whether or not this subcommittee and the Congress can feel some comfort with those changes.

Mr. GUNDERSON. Yesterday the Farm Credit Administration and the Farm Credit System came and asked for $5 and $6 billion respectively in assistance. I asked them what economic assumptions in agriculture they were basing that particular need on. You have reviewed, probably more than anybody in this room, the different projections within farm credit, within farm income. They suggest that they are using USDA projections of farm income in 1986 and 1987. Are you aware of what projections they are using?

Mr. NAYLOR. Yes, Mr. Gunderson, I am, and I think it is important for us to remember that this isn't a need that even they themselves anticipate, based on those assumptions, would ever need to be tapped. Indeed, using their own numbers and the assumptions that we have worked with, they would never exhaust their earned surplus. It would not dip below—which would occur in 1987—some $700 million plus $5.5 billion worth of members' stock, which is a very strong position even at that point, a capital ratio of 8 to 1. That's a strong financial institution, if you compare it to commercial banks or other institutions in this country, even at that point. Then in 1988, after the system has fully reserved for all of its anticipated losses, it turns profitable and it begins to rebuild. That is the basic economic situation.

Now the $5 or $6 billion is what I would describe in part as a comfort factor, a cushion that is strictly a judgment call. Whether that needs to be $1 or $6 billion or $2 billion or there at all is a call based on their capacity to manage efficiently and fairly their problem loans.

Mr. GUNDERSON. I just have to share with you that there is great discomfort in this subcommittee over that assumption. I don't believe that this subcommittee, and I'm convinced the Congress as a whole is not going to be willing to deal with this issue year after year after year, saying, "Well, last year's projection was too optimistic." As Congressman Coleman indicated earlier, we have all been told in private briefings as much as 2 weeks ago that $10 to $15 billion would be necessary. Now all of a sudden we are down to $5 or $6 billion. We have got to have concrete understanding of the assumptions used and the exposure which does or will exist before I think many of us are willing to move forth. Is that an unreasonable request?

Mr. NAYLOR. You reflect the frustration of the administration itself in the very question you have asked me, the question of Federal assistance. We have had a very difficult time getting an accurate fix on the depth and the extent of the real exposure the system may have and what its real losses may be. We do and we will accept, based on USDA projections, that that potential is there, and I emphasize "potential." Their own projections of their losses may be significantly less than that.

The difficulty in getting a fix system exposure is that it is exactly that, projected. It isn't hard losses they have on the table today. It's what may happen to them if the economy continues on the track projected by the Department; developed as an economic assumption for the general agricultural economy, it's what might happen over the next several years. That, as you are well aware, can be a very fluid situation. It depends on what the farm bill contains, for example. That has a significant impact on what will happen to this system.

Mr. GUNDERSON. Thank you.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Gunderson. Before the Chair recognizes any other member of the subcommittee for questioning, I would like to at this point recognize Chairman de la Garza of the full committee and Mr. Madigan of the full committee, who are both here with us. I yield now to Mr. de la Garza for any statement he might want to make.

The CHAIRMAN. Thank you, Mr. Chairman.

I don't want to take the time of the subcommittee or Mr. Naylor. We know his position. We don't agree. I would hope that he would have come with something more substantive or something that we could work in a more expeditious manner, but I guess we'll just have to go our own way and see what we can do.

We appreciate your being here, Mr. Secretary. We don't like the tidings you bring, but they're not of your own making, so we forgive you for that. [Laughter.]

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Chairman. Now the Chair recognizes Mr. Madigan for any statement he might like to make.

REMARKS OF HON. EDWARD R. MADIGAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. MADIGAN. Mr. Chairman, thank you very much.

Secretary Naylor, I want to congratulate you on what I think is a very positive statement. I think from time to time we all need to be reminded that the Farm Credit Administration has been less than candid with the Congress over the past 2 or 3 years. If they had come forth and told us the truth a year ago or a year and a half ago, and if we had reorganized the system along the lines being suggested now at that time, many of these problems and perhaps none of these problems would have existed. So I think we need to be reminded of that every once in a while, that they were less than candid with us, and I am not going to forget that.

With regard to the criticism made of you not having offered a definitive amount of Federal assistance this morning, I want to say that I regard your statement as having opened the door for administration participation in some kind of Federal assistance, and I think it positive in that regard. I would say that if you had named a specific amount, some would say that that was not enough. Others might regard it as a Federal bailout and being too much. I think what you have said this morning is a very constructive thing and very appropriate, and I want to congratulate you on your statement.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Madigan.

Before I do yield to Mr. Daschle for questioning, I want to recognize some members of the committee who are here this morning, other than the subcommittee. I recognized Mr. Huckaby before when he was here, and he is still here. Mr. Olin of Virginia, we are glad that you are here. Mr. Bedell of Iowa, we are happy that you are here. Mr. Penny, we are pleased that you are sitting with us. Mr. Combest is here. Mr. Schuette, and Virginia Smith, a Member of the House of Representatives who is interested vitally in agriculture.

We appreciate all of you being here. Is that everybody? We do appreciate all of you spending your time here. Instead of this looking like a subcommittee meeting, it looks like a full committee meeting.

I now yield to Mr. Daschle for 5 minutes.

Mr. DASCHLE. Thank you, Mr. Chairman.

I find myself in agreement with Mr. Madigan many times, but on this particular issue I have had the belief for a long period of time that this issue is a lot more than just reorganization of a system, but that's what I hear you telling us as well, that all we have to do is to reorganize the system and things are likely to be much better. Speaking figuratively, it seems to me that we have a house—call it the house of agriculture—and while the whole foundation is caving in, you are redecorating the upper bedrooms. It seems to me that unless we recognize that there is far more to the problem that redecorating some rooms and changing the furniture, that we are never going to solve this thing.

From what you told us this morning, it seems to me you are looking at this in three stages. First, you are going to redecorate the rooms. Then you are going to assess whether we have to do anything more structurally significant to the foundation and, third, if that is necessary, put some more money into the foundation and try to bolster it. But let me ask you this: How do you project the damage to be assessed in the future? Have you looked at next year, given the income projections?

If you come to the conclusion that simply making the changes structurally that you have proposed this morning and if, God forbid, we have to come in with some money—which is what I understand to be your second phase, that you will come to us in support of at some point—if that isn't enough, what is, in your opinion, the third step? What do you see we must do after that, because I think we are already there. I think the foundation has already crumbled, I think it's ludicrous for us to be wasting our time, if all we are going to be talking about is rearranging the furniture. We have got to not only talk about money that may or may not be necessary to pour into the Farm Credit System, but we all ought to be talking about how we are going to rebuild that foundation. I haven't heard you address that this morning.

Could you give us the administration's projections on income next year and whether or not we have the right to be confident that, whether it is $5 billion or $10 billion, that that money is really going to stay there and it is going to restabilize the agricultural community?

Mr. NAYLOR. Mr. Daschle, I think you and I both know we're talking about two separate and distinct issues, one of which this subcommittee has already addressed, or the committee as a whole, and that's the question of basic farm legislation which is now being debated in the Congress and on which there is substantial disagreement on a number of features. Clearly the effect of farm legislation will affect the overall situation for any lender, because it affects the repayment ability of individual producers depending on what form it takes, and that could be any form.

We recognize that there does indeed have to be orderly and strong support during a transition period for our producers, changing to a market-oriented policy, putting some strength and viability back in that economy for our American farmers, and we——

Mr. DASCHLE. That is so nebulous, I've got to tell you.

Mr. NAYLOR. Well, Mr. Daschle, this hearing is on a financial institution. I would be happy to cover the farm bill if you want.

Mr. DASCHLE. They are not unrelated. Listen, they are not unrelated, and you know that. The reason we are in this big mess is that we haven't had a farm policy in the last several years that has brought about farm income. If we had had farm income, I doubt very much that we would be here, regardless of how messed up the Farm Credit System may be, and I think we both know that.

The real question now is, what do we do about farm income? I guess I would just ask you, is it your honest opinion that with what we have passed in the House, that we can see an improvement in farm income next year? If you can't answer affirmatively to that, then we are wasting our time considering any amount of money in the Farm Credit System.

Mr. NAYLOR. Mr. Daschle, the assumptions, including the projected farm incomes, anticipate under any scenario some modest decline potentially in the next year——

Mr. DASCHLE. A modest decline?

Mr. NAYLOR. We are aware of what these assumptions were based on. The Farm Credit System did use the projections of the Department as a basis for making some of these assumptions.

Mr. DASCHLE. What is your view of what "modest" is? I mean, how much income decline do you anticipate next year?

Mr. NAYLOR. Mr. Daschle, I didn't bring the farm bill details with me but I'll be happy to supply them for the record. I think you are aware, as much as anybody else, that there is substantial disagreement even among the people in this room as to what form that farm legislation should take and what is the best solution to having a sound transition and adequate income in the future for our producers.

Mr. DASCHLE. Well, Frank, we just had Don Wilkinson in here yesterday saying that all of what they have told us about how serious the situation is and what they need and what they must do is not dependent upon how we rearrange the furniture but on one thing—that things get better. I have to tell you, if what you're telling me is there is going to be a modest decline, and if modest decline may be $10 or $15 billion in reduced income from this year, then we are really wasting our time talking about bailing out anybody, because what we ought to do is to go back to the drawing board and bring about better income. That's the only thing we can do.

Mr. NAYLOR. Mr. Daschle, what we really need is sound farm policy. Throwing dollars in the programs we have been working with has not improved the economy of the farmer. We need some fundamental policy changes, and while we can debate that at some length and it will be debated on the floor, we agree that we need to improve farm income, but we need to do it properly.

Mr. DASCHLE. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Daschle, for those questions.

The Chair now recognizes Mr. Evans for 5 minutes.

Mr. EVANS of Iowa. Thank you, Mr. Chairman.

Mr. Naylor, I confess to some disappointment about your statement. I do, however, think that you have helped this subcommittee to define its point of departure on legislation. You have set forth rather clearly two points that I think this subcommittee is going to address, and I would like to use the remainder of the time trying to get a better feel for other parts of the fence that may be around this block of legislation that the Department might be favoring at this time.

For example, is it your view that we should stay within the bounds of the Farm Credit Act in anything that we do between now and the end of the year?

Mr. NAYLOR. We generally believe that modifications to the Farm Credit Act will be adequate to deal with this situation.

Mr. EVANS of Iowa. You would not automatically oppose going beyond that, but that's your basic belief, or would you go further than that?

Mr. NAYLOR. Well, Mr. Evans, additional components are the guaranteed program of the Farmers Home Administration and the discussion on the Senate side of an interest rate matching arrangement which would be available both to the commercial banking industry and to the PCA's, particularly, within the Farm Credit System. That is a separate issue but we very much recognize its integral relationship with this situation.

Mr. EVANS of Iowa. To pursue that point of the commercial banking system a bit further, I understand I think exactly what you said. I would point out something I know you understand also, and that is that there are certain things that can be done within the bounds of the Farm Credit Act that would be of interest to commercial bankers. You are not, by your statement, saying you don't want any of those things to be considered at all, are you?

Mr. NAYLOR. I'm not sure that I'm entirely with you.

Mr. EVANS of Iowa. Well, let me proceed just a bit further.

Mr. NAYLOR. All right.

Mr. EVANS of Iowa. The Governor of Iowa earlier testified that some, at least, think that without substantial Federal intervention as many as 40 PCA's, 3 intermediate credit banks, and 2 land banks may be liquidated in the foreseeable future. We didn't pursue the basis for those numbers but I'm sure there are those out there who feel that something like this could conceivably happen.

Recognizing that such a catastrophe would greatly reduce the ability of the Farm Credit System to retail its credit to farmers, does the administration have any basic philosophical objection to, within the Farm Credit Act, broadening the possibilities of that retailing function being handled by commercial agricultural banks? Before you answer, I will say that this was raised yesterday with Governor Wilkinson and that he said he could see some possibilities in which that might be very important, and he had no philosophical objection to this subcommittee at least beginning to consider that eventuality. Do you have any comments on that particular point?

Mr. NAYLOR. Mr. Evans, the current Farm Credit Act provides for access by commercial banks, under what is known as other financial institutions, to the window of the Federal intermediate credit bank. We have not proposed or discussed any change in that basic authority or option that currently exists within the act.

Mr. EVANS of Iowa. So you have no opinion on that at the present time, as far as an official opinion of——

Mr. NAYLOR. We have not looked at that issue, beyond not changing what is currently available through the current law, which does permit commercial banks access.

Mr. EVANS of Iowa. I can't see my light. I guess I have some time left.

Another area that I would like to explore just a bit, you have pointed out how strongly capitalized the Farm Credit System is, and on paper you are certainly correct. In view of that very strong capitalization, and recognizing that pressure on capital accounts may be severe, at least in the case of some associations and some banks on a temporary basis, what is the position of the administration on perhaps providing some temporary relief by statutorily permitting the Governor to temporarily ease some of those capital requirements on individual institutions that are subject to very strong pressures?

Mr. NAYLOR. Mr. Evans, there is some flexibility in that, in the Governor's or the director of the regulatory agency's authority, that we have discussed. It also provides for the ability to move and pool resources within the system to help those units that are under stress.

Mr. EVANS of Iowa. I am out of time, and I thank the chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Evans. You will be given an opportunity for some more questions, if you like, later.

The Chair now recognizes Mr. Stenholm for 5 minutes.

Mr. STENHOLM. Thank you, Mr. Chairman.

Mr. Naylor, my first note I wrote after listening to you was to commend you for accentuating the agency status of the Farm Credit System in your testimony. Then I struck it out after listening to your answer to Mr. Glickman, but now I put it back in, and I do so because I believe in your heart you know it's right. [Laughter.]

I will not press you any further, because you are the messenger here today and I believe that you know, and I hope I am correct that you will carry that message back to the folks that are going to make that decision, because if we don't achieve that result, we are in trouble.

You also stated that what the farm bill has in it will affect the Farm Credit System. We all agree to that. If the Senate should reduce by any amount the amount of income protection that the House agricultural bill has in it, will it affect the subject which we are here today to talk about?

Mr. NAYLOR. Mr. Stenholm, I will have to look at the specific area, but I do not think it will materially change the projections that were used——

Mr. STENHOLM. Wait a minute, now. I'm not talking about projection. We're talking about 1986, in which wheat farmers are already planting a crop, in which they know not what the program is going to be. But if the Senate should approve any change in the amount of moneys that would be available for farmers to spend, making their crop, paying their interest, paying the principal, will that have an effect for this committee's consideration on what the package for the Farm Credit System should look like?

Mr. NAYLOR. Mr. Stenholm, I believe the system used departmental projections which anticipated a somewhat lower budgetary commitment than the current Senate bill provides. If that is the case, and I believe it is but I'll verify it, the answer would be no, it would not change the projections.

Mr. STENHOLM. I disagree with you very strongly on that, Mr. Naylor, and I hope you will revise that in your further statements down the line.

Let me go ahead, because you bring up the budget and that's the final point that I want to make. Again, I realize you are the messenger here today and I realize you cannot give the answers I would like to ask you as specifically as Mr. Glickman did and others, and Mr. Gunderson. I realize you can't, but as of this moment there is another conference going on in this building called the Gramm-Rudman-Hollings balanced budget amendment. It will have a tremendous effect upon agriculture, a tremendous effect, and I want to give you some numbers because that's what we're talking about today.

I found it extremely interesting that in one of the proposed amendments yesterday on doing something about the deficit, which I happen to believe is the most critical point for solving this farm credit dilemma we're in today—we've got to solve that deficit—but when a proposal was made by my side of the aisle to cut the deficit quicker and make it do more, it was termed nonsense. That bothers me, because by doing it quicker and doing more of deficit reduction, I believe we are going to do more for the Farm Credit System and the long-term dilemma than any one thing.

But here is the point. We had representatives from the Department up. The economist, Mr. Thompson, was up the day before yesterday, and we had a tremendous amount of interesting questioning because we really don't know how this is going to effect, except we do know this now: Spending in the 4 years of the previous administration for agriculture was $42.7 billion. Spending in the 4 years of the current administration is $72.6 billion. That's an increase of $29.9 billion, which we all agree that that has not produced prosperity on the farm because net farm income during this same period of time has declined by $20 billion in real income, and one of the reasons why we are having this hearing today.

But when we talk about deficits we find that agriculture is going to have to bear 10 percent of the cuts to reduce that deficit. It is interesting, when we look, that agriculture was responsible for 6 percent of the increased deficit. It is also interesting to note that when we talk total outlays during the last 4 years, agriculture is 2.1 percent of our total spending, and yet we are going to stand 10 percent of the cuts.

Now I don't want you to answer this question because you can't, Frank, but I want you to think about this and use this when you go back and talk to the man that can make these decisions. We have to recognize the deficit is important, and we have to recognize that if we are going to make the kind of cuts out of agriculture, there is going to have to be a change in the macropolicy. Again, I have to so strongly disagree with you when you say, "If we cut income from farmers, it is not going to affect their ability to pay back the loans we're talking about in 1986," because I think that it is.

Mr. NAYLOR. Please, Mr. Stenholm, you asked what the assumptions were, and I believe the assumptions on the projected losses for the system, just this data here, were based on departmental figures that anticipated a lower expenditure than what is currently before the Senate. Now obviously if that figure was higher, these numbers might be reduced. If the income component was higher, the loss exposure might be reduced further.

I want to verify for you, though, that the Department assumption on the spending level was used as the basis for projected losses. I believe it was but I will verify that to be sure.

Mr. STENHOLM. I don't want to quarrel with assumptions or what have you, because you made another statement—and my time is up but if I could have 20 more seconds, Mr. Chairman—when you say that we are in this position today because of a lack of income. All the reasons for us being there are so well established, but getting out of this position, we are 6 months pregnant. The Farm Credit System, farmers, et cetera, we can't stop it. We certainly cannot stop it with less income.

You are totally correct when you say the farm bill we produced, certainly the one you suggested earlier this year, or any other idea that has been before this cubcommittee, is not going to go anything about the next 12 months' farm income picture. That die is cast. It's done. It's set. That is why I say when you suggest that we can take less Federal help for farmers in the next 12 months, and this committee can deal with the credit problem, I don't see how we can do that. I hope that if you really believe your answer to me, that you will share that with me and this committee very soon, because I think it is awfully important to us as we deliberate.

Mr. NAYLOR. Thank you, Mr. Stenholm. I believe it is very important. We want to work very closely with the committee and have a common basis on what the assumptions and what the actions will do. One of the great problems we have had, of course, with this is that everybody is using a little different set of numbers, and it causes an enormous amount of confusion. It causes an enormous amount of concern, some of it totally unfounded, at a time when producers are already under a lot of stress and we don't need to add to it.

Mr. STENHOLM. If I might, day before yesterday Mr. Thompson was giving numbers that this committee was over budget. Yesterday I noticed Secretary Block was acknowledging that we stayed within the budget, based on the January baseline, and I appreciate Secretary Block correcting the record as far as the committee is concerned.

Mr. JONES of Tennessee. Thank you, Mr. Stenholm.

The Chair now recognizes Mr. Morrison for any questions that he might have.

Mr. MORRISON. Mr. Naylor, do you anticipate an expanded role for Farmers Home Administration in dealing with the perceived credit crisis?

Mr. NAYLOR. Not in directly dealing with the Farm Credit System itself but indeed, yes, we do anticipate an expanded use of our guaranteed authority both for the commercial banking system and for the Farm Credit System, those who have access to that.

Mr. MORRISON. Do you have the feeling that your guaranteed program is looking better all the time?

Mr. NAYLOR. Yes, sir, it is indeed, and we had lengthy work with the commercial banking industry and the Farm Credit System this summer to take further steps to make the program more viable, workable. We have over 2,100 of the 4,500 agricultural banks now working with us as approved lenders and essentially all the Farm Credit System. We got a very late start last year but the activity is substantial and we expect it to continue along those lines.

Mr. MORRISON. Do you anticipate requesting of this subcommittee changes in Farmers Home to accommodate some of the pressure that many of us feel is going to come from current borrowers from the Farm Credit System as they move down the economic ladder?

Mr. NAYLOR. We don't believe that we need any additional legislative authority; the current authorities within Farmers Home give us enough discretion to manage our programs and make them effectively available to the commercial lenders.

Mr. MORRISON. Are the dollar amounts sufficient in the House-passed version of the farm bill to cover additional costs?

Mr. NAYLOR. We are going to have to monitor that very closely, Mr. Morrison. I think that there is obviously going to be some difference of opinion on that. We have generally proposed on the Senate side a 2 and 2 base on operating credit, which we think is adequate—by that I mean $2 billion of guaranteed, $2 billion of direct—but we are going to have to monitor that very closely as we move into the lending season.

Mr. MORRISON. Thank you, Mr. Naylor.

I yield back, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Morrison.

Now the Chair recognizes Mr. Thomas for 5 minutes.

Mr. THOMAS. Thank you, Mr. Chairman.

Mr. Naylor, the one thing that really confused me was how optimistically your opinion of the land bank's situation at this time, the farm credit service at this time, compared to the total preponderance of the testimony we have heard here, not only today but in the past few weeks in other hearings, in other sessions. Absolutely nobody that I have heard agrees with your assumption about how sound the land bank system is at this time, so I think you need to be aware of that. I guess you are.

But out of this—and I am not going to take my full time, I don't think—but I have felt all along, and we assumed this when we got into the farm bill this year, that we couldn't do everything we needed to do for agriculture there. But when we got into this credit situation, I felt all along we would begin to see the true depths of the despair and the depths of the problem that face agriculture today. I fully feel that if we are honest with ourselves after having looked at it, when we look down the icy throat of this dragon, that we are going to go back and address a number of things in agriculture. We are going to have to go back to this issue of farm income and market price.

Yet what I still continue to hear, and I have heard it over this past year, was all that we've got to do is to get our farmers out there and get them competitive on world markets. There is not a member of this committee up here, I don't believe, that would stand up and say that the prices that products are selling for, farm commodities on the world market, are a realistic price or a sustainable price that other countries can continue to produce at. Yet here is what we are saying, again, is we have got to get our farm prices out there on those markets competitive, when our farmers are going broke at the prices that they are producing at now.

There is no doubt in my mind, even your own projections show, that next year's projected farm income won't even pay the interest on the debt. So here we are today, and if I am hearing you right, there is some approach to simply shore up the land bank. I think the analogy of decorating the top floor of the house while the foundation crumbles is very accurate. Here we are talking about doing some little simple step here with farm credit services, when the whole thing continues to deteriorate.

Now I am going to tell you, I am personally, literally frightened by the prospects that face agriculture today. I wake up in the middle of the night on many occasions—I am being perfectly candid with you—and when I look at the task before this Congress, and this is the only place that the agricultural problem is going to be settled, is here in the Federal area, it has gotten so big and so monstrous that it is the place of last resort that can help it, if we make that determination. When I look at the task before us and I see how broad and how deep it is, I have often literally despaired that we can do it.

But I can tell you one thing for certain, and this is a message you need to take back: We cannot do it unless the President himself signs on the issue, and I have yet to hear him make a major speech on the agricultural problems in this country today, when we sit here and listen day in and day out to testimony that literally breaks your heart with what it's doing to this countryside. I have yet to hear Secretary Block get up and do this. So I can tell you this committee will do its best and will work the best will it can, but until you somehow take back to the President the message that he has got to make it a national issue, and it's time we faced up and realized the facts instead of coming down with these little platitudes and ideas like things I have heard, such as this wonderful silent revolution that is going on in soil conservation across the United States today. That is absolutely a pipedream. Nothing substantiates that.

So I am just going to close my comments. You have been referred to as a messenger. I hope you will take that message back. America's farmers and America's rural people are waiting to hear from the President, Mr. Naylor.

Thank you, Mr. Chairman.

Mr. NAYLOR. Mr. Thomas, I will be happy to supply you with Mr. Block's and the President's very substantial and frequent comments about their concern for the need to make some fundamental changes to get some health back into our agricultural economy. The policy——

Mr. THOMAS. What I hear, Mr. Naylor, is a "leaner, cleaner agriculture." Those are the words I hear coming out of the White House, and I think you must realize that this idea that we are going to go through this little transition, as you continue to refer to it, and that we can sustain what it is going to do to this country's agricultural structure and come out of it still healthy with an agricultural structure of any semblance, that's wrong. It's erroneous. If you can't look at the facts that have been given here and see that the whole thing is pulling everything down with it at this stage of the game, I don't know what kind of further testimony you have got to hear.

I have strayed from the comment. I know you came here to talk about your specific proposal, but in Mr. Daschle's own words, how can you simply talk about this one facet of the problem and not look at the whole, broad spectrum? It has to be a national issue and, once and for all, the President and this administration has got to sign onto this.

Mr. NAYLOR. Mr. Thomas, I think you are well aware that this issue is being discussed daily beyond that. It is quite correct, this is a hearing aimed at a particular component of the problem, but the overall structure and solution on farm legislation is the key to the overall improvement of the picture. That must be addressed and is being addressed, outside the scope of just this one specific subject.

Mr. JONES of Tennessee. Thank you very much, Mr. Thomas, for those questions.

Now the Chair recognizes Mr. Franklin for 5 minutes.

Mr. FRANKLIN. Thank you very much, Mr. Chairman.

Frank, as I always do when I get you here and because of the specific district I represent, I have to talk about Farmers Home Administration policy. Do your foresee this situation in the Farm Credit System as giving us an opportunity to comply with the administration's request to move more of your Farmers Home Administration loans to the guarantee program and away from the direct program?

Mr. NAYLOR. I believe that there is a good deal of interest in the commercial banking and Farm Credit System to do that. Their interest is, I think, evidenced by their willingness to work with us and their very close cooperation to make a number of improvements in that program for the coming year.

Mr. **Franklin**. I would like to suggest to you a method by which maybe we could possibly solve two problems. If we are going to have to infuse capital or guarantees into the Farm Credit System in whatever way, it would seem to me that it would afford us an excellent opportunity to get a little tit for that tat, in requiring or at least heavily suggesting to the Farm Credit System that, in exchange for any infusion that we make there, that they cooperate with us in trying to accommodate some of the Federal debt that has accumulated out there through the Farmers Home Administration, particularly if we are going to scale down our direct loan program. Do you foresee anything that we can include in anything that we do here that would help to get the Farm Credit System more interested in assuming some of these Federal obligations that are out there?

Mr. **Naylor**. There are some provisions incorporated in the Senate proposal for farm legislation that would make it possible or more practical for commercial and Farm Credit System lenders to participate in some of our areas of lending. I hope that those might pass. It would be very helpful in your district, for example, if some of those steps do indeed come to pass.

Mr. **Franklin**. I want to follow up just a minute on something that Mr. Morrison said earlier today. He asked you the specific question, did you think that the amount of funding contained in the farm bill for Farmers Home Administration was sufficient to meet what you consider to be an accelerated need for Farmers Home Administration participation. I believe you said that you would have to reassess that as the thing went along further and how it finally came out of the Senate. Is that correct?

Mr. **Naylor**. We are going to have to continue to assess it as we move forward, despite an enormous increase over the last 4 years. The last Carter year we had about $700 million of operating loan authority in Farmers Home. We are now talking about on the Senate side, as I mentioned, $4 billion in a matter of 5 years. That's an enormous increase but it also reflects an enormous expansion of activity and responsibility for Farmers Home and by the commercial sector using our guarantees.

Mr. **Franklin**. Will it be the administration's position again this year that the Farmers Home Administration funding should be increased in order to accommodate some of the problems that are out there with the Farm Credit System and other lending agencies, such as commercial banks, that are letting these farmers go?

Mr. **Naylor**. We hope that the proposals we have on the table are adequate. I recognize that we are going to have to continue to monitor them with Congress and the administration as we move into the lending season.

Mr. **Franklin**. All right. Thank you, Mr. Naylor.

I yield back the balance of my time, Mr. Chairman.

Mr. **Jones** of Tennessee. Thank you very much, Mr. Franklin.

Now the Chair yields to Mr. Stallings, 5 minutes.

Mr. **Stallings**. Thank you very much, Mr. Chairman.

Mr. Secretary, just a couple of questions: I am puzzled by what we are hearing today. In the last few months of my experience on this Agriculture Committee we have heard several different kinds of projections. We have seen a record crop come in this year. We have projected, you have suggested here, a modest decline in farm income for the next year. We recognize our farmers are going to be forced to pay higher interest in the next year, whether they come through the Farm Credit System or through commercial banks. In fact, we are hearing from many of the commercial lenders that they are not going to be as willing to lend to farmers next year. We heard yesterday about declining land values, and of course the Governor of Iowa spoke very eloquently on that. We recognize we are going to lose more of our international markets.

I am puzzled as to how this suggestion of yours is going to really turn this around. I would suggest that in the next year we are going to see tremendous pressure on the Farm Credit System, more so than perhaps we have ever seen before; that we are going to see farmers who have traditionally gone to commercial lenders, but that option will no longer be necessary. First of all, do you think the Farm Credit System will be able to handle this increased demand for money? Second, how long before we will be revisiting this problem again?

Mr. NAYLOR. Mr. Stallings, I hope that if we can work together, we will provide an action that will make it unnecessary to visit this subject again. It does not serve the American farmer's interest, or the Congress', to continue to revisit this subject time and time again.

On the question of whether or not they have the capacity to do the lending, yes, as long as they have access to the market at competitive prices, they most assuredly can respond to the needs of their borrowers, and other borrowers may come forward. That is the crucial issue. That's really what the question is here: What kind of structure is needed to provide that assurance to the marketplace, so that the investor will be prepared to offer funds to that system at competitive rates? This will provide farmers with the access to credit they must have. It can be done if we will work diligently to do so.

Mr. STALLINGS. Now most of the testimony we have heard tells us that this farm credit crisis reaches far beyond the Farm Credit System. You are telling us today that a more extensive Federal Farm Credit System really isn't needed. What do we tell our farmers who aren't borrowers from the Farm Credit System, and yet are insolvent and are as desperately in need of assistance as the borrowers of the Farm Credit System?

Mr. NAYLOR. Mr. Stallings, we have a very substantial commitment through the Farmers Home Administration to provide additional credit backing to make it possible for the commercial banks to stand behind their farm borrowers. We intend to continue to work to make that program effective in meeting the needs in that particular system. The hearing today is addressing a specific problem, on a particular financial institution and its capacity to meet its responsibilities. I would be happy to discuss further the problems being faced by the commercial banking industry, and how effectively the resources that we have committed to them can make it possible for them to meet their needs and ability to service farmers in their area.

Mr. STALLINGS. Finally, and again I'm not sure that you can answer this, but when these organizations were initially established—the Farm Credit Systems and the Farmers Home Administration—it seemed to me their purpose was to help farmers. Their purpose was to get credit to the agricultural community, particularly in areas that would have a hard time getting it otherwise.

I have spent most of my time this year dealing on an individual case with the Farmers Home Administration in my State, doing battle with them. It's almost a confrontational experience in which individual farmers are being driven out of business, not being informed of the various options available to them, and in fact being dealt with I think in a very callous manner. Here is an organization that, as I understand it, was set up to help farmers, now becoming perhaps one of their greatest enemies.

Now it seems to me that both your side of the Hill and our side of the Hill have got some responsibility to make sure these systems work as they were outlined to and, if we are not happy with them, then to change them, but while they're in operation they ought to be functioning as they were originally set up to do.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Stallings.

The Chair now yields to Mr. Jeffords for questioning, for 5 minutes.

Mr. JEFFORDS. Thank you, Mr. Chairman.

I have two questions. I don't expect a lengthy answer at this time but I would appreciate some response, as I anticipate you will have a more lengthy explanation at some point. You make the statement that, "Based on the assumption made by the operating system and its accountants," things will look pretty good by 1988.

I would appreciate knowing what those assumptions are, and especially what kind of assumptions you made as to what the farm program would be during that period of time. Will that be forthcoming to us?

Mr. NAYLOR. We have the capacity to provide that and will do so. We are using the same numbers, and it is important to understand that the system is facing a very serious problem, and they are going to be reporting record potential losses the next 3 years, including 1985, 1986, and 1987. That is going to be of major proportions.

Our discussion here today has focused on the fact that they also have enormous strengths built up over a long period of history, which they have not tapped yet, to work with and help our producers and farmers get through a very difficult period. The system can provide workout situations for many of those operators on a prudent basis, if we can give them the necessary authorities they need to be able to move assets where they are necessary.

Mr. JEFFORDS. Now that's the second part of my question. It is my understanding that all of the districts have agreed to stand behind the bonds, so that they are joint and severally liable upon default. They also have an existing voluntary agreement wherein they have agreed to transfer some of their reserves in order to assist the distressed banks. I am a little bit concerned that you are asking for the authority to do that other than by a voluntary agreement and to order the transfer of the assets from the sound banks to the troubled banks. Is that essentially what you are asking?

Mr. NAYLOR. Essentially what we are proposing is to give the system, which is jointly and severally liable for its obligations, the ability to move its resources to where it needs them quickly and in a timely fashion. Currently the agreements do not trigger until we are financially beyond an easily recoverable——

Mr. JEFFORDS. I understand that. My question, though, is what is equitable for those banks which have been well managed and have equity and are not in trouble. It's my understanding that those banks represent about 14 percent of the system's overall loans or assets. Do you intend to protect the farmers who have that equity in those banks, or are you recommending that there just be an arbitrary transfer which would swallow them up into the abyss that exists out there?

Mr. NAYLOR. Mr. Jeffords, I think it is important to remember that we do not and have not, in any of these discussions, proposed jeopardizing the borrower stock investment. What we are talking about being able to move around is earned surplus which is accumulated for exactly this purpose, for problem periods, by the financial institution. That's why those funds were accumulated and that's the purpose that they serve, and we are now in that situation. The problem is, the system has not had the capacity to move them rapidly and efficiently to where they are needed.

Mr. JEFFORDS. Well, that's a little bit different than my interpretation of what the expectations were when these institutions were set up, and as to what the understanding is of the farmers that have joined those banks, so we may have a disagreement over that. It seems to me that it might be proper to assist on a voluntary basis as we have seen doing. It is important that contributing banks have some security for return at some point of those assets, for those were contributed by those farmers in that particular district. It seems to me that it would not be fair to arbitrarily take those reserves out and distribute them to areas that happened to be in need, without any interest remaining to those who provided those assets.

Mr. NAYLOR. Mr. Jeffords, there are provisions on how those funds would be moved. We anticipate that there are some responsibilities that have to be observed on how the process would be handled, but the earned surplus—and this is a cooperative, in which we all stand together and deal with our problems jointly, and that is the idea behind agricultural cooperatives—that earned surplus is there because of each unit's ability to access jointly very favorable rates in the securities market, and that's why those surpluses were able to be accumulated. The problem could just as easily, under another set of circumstances, have existed in any of these districts.

Mr. JEFFORDS. My time has expired.

Mr. JONES of Tennessee. Thank you very much, Mr. Jeffords, for your questioning.

Now the Chair recognizes another distinguished member of the subcommittee for questioning, Mr. Tallon.

Mr. TALLON. Mr. Chairman, thank you very much.

Mr. Naylor, is there any existing authority for the administration to extend a line of credit for the Farm Credit System without legislation?

Mr. Naylor. No, sir. There is a very limited authority currently existing but it is on a rather small side. There is some access, also, to the Federal Reserve provided in current legislation.

Mr. Tallon. Mr. Naylor, how large is this limited authority?

Mr. Naylor. Roughly—well, it's divided up between each of the units, but the total is a little over $200 million.

Mr. Tallon. Thank you. Mr. Naylor, I think you said the system's earned surplus of more than $5 billion is adequate to handle the problems. However, yesterday the system admitted that this earned surplus is, for the most part, invested in farm loans which are steadily deteriorating in value. The system estimated this earned surplus will have declined to slightly over $1 billion by the end of 1986. Now is that going to be sufficient to cover the system's losses?

Mr. Naylor. Maybe we need to make one point clear. The system on September 30 reported a substantial operating loss. However, much of that operating loss was reflected—in fact, most of it—in transferring funds from one account within the surplus to a reserve for losses. The total funds available to the system essentially remained the same, as did their financial ratios. What they are in the process of doing now is very aggressively identifying and setting aside funds for potential future losses, which is prudent and a proper action on their part, and one that needs to be continued. But those funds still are present within the system and available to deal with those losses, if and when they finally occur.

Mr. Stenholm. Would the gentleman yield?

Mr. Tallon. I yield to the gentleman from Texas.

Mr. Stenholm. Mr. Naylor, one point of contention from the Texas district bank, farm credit district bank, has been as far back as 1977, a dispute between the Farm Credit System, IRS, Treasury, et cetera, as to how large loss accumulations could be. We know that under the law the 3½ percent, et cetera, with additional amounts allowable, but yet we have constantly been denied the ability to build up reserves to look to a day like today. Is this being discussed in any of your meetings with other agencies, for example, IRS and Treasury, as to the need to look at the valid needs of some production credit associations, some land banks, some districts, some areas, to accumulate greater loss reserves?

Mr. Naylor. Yes, Mr. Stenholm, it is, and one of the problems is the way the system treated problem loans and reported them. One of the recommendations coming out of Price-Waterhouse & Co. is to revise the standards and criteria which identify potential problem loans and to properly reserve for them. That represents a very significant change which is occurring right now in the system's operations and will have a very definite impact on their ability to adequately reserve.

Mr. Stenholm. I agree, and that is a very good sign. I hope we will pursue it all the way to the other agencies necessary.

Thank you for yielding.

Mr. Tallon. You're very welcome.

Mr. Chairman, I yield back the balance of my time.

Mr. Jones of Tennessee. Thank you very much, Mr. Tallon.

Before I yield to any other subcommittee member who has already been heard, I am going to apologize to those who are sitting with us this morning for not being able to yield to them. We simply do not have the time today, folks, to do that, but I am appreciative of the fact that you are here.

Frank, for the record, I have only one question that I am going to pursue because I am going to take the liberty of asking you whatever questions that need to be asked even when this hearing is over, but for the record, what is the administration's position on the question of legislation which would establish an explicit Federal guarantee of Farm Credit System securities, either permanently or on a temporary basis? I don't believe we have covered that this morning.

Mr. NAYLOR. Mr. Chairman, the administration has not yet taken a specific position on that. We are prepared to work with the committee to look at the situation on these first two issues, and then to give you that answer and develop an appropriate action in that area.

Mr. JONES of Tennessee. Thank you, Frank.

Let me make this announcement. There will be no break for lunch. Those who desire to have lunch may do so. We have a Member of Congress that we are going to hear after Mr. Naylor. Then we are going to hear the attorneys general and then proceed with the other panels following that.

But now I have at least two members of the subcommittee who have some additional questions, and I yield at this time to Mr. Weaver.

Mr. WEAVER. Thank you, Mr. Chairman.

Mr. Naylor, I want to ask you some technical questions bearing in on the—you recommended certain legislation provisions this morning. The possibility exists that you may want the authority to have the U.S. Government assign a line of credit or some other financing mechanism backed by the U.S. Government for the Farm Credit System. Do you need legislation for this line of credit, or do you have the authority now in any way, shape, or form to make such a thing if you so decide to do so?

Mr. NAYLOR. Mr. Weaver, I believe that legislation is needed for most of what we have discussed today. However, I would defer to our attorneys and will provide you with a precise answer.

Mr. WEAVER. Thank you.

Mr. NAYLOR. We do have some authorities that are not real clear.

Mr. WEAVER. Where is your attorney?

Mr. NAYLOR. Our attorney is not here, Mr. Weaver. I don't have an attorney with me. I will provide you that——

Mr. WEAVER. Well, no. If you're not prepared to answer that, you're not prepared to answer anything, Mr. Naylor. Certainly you can tell us what authority the Federal Government now has to do this, and if legislation is needed for a line of credit or any form of backing, or cash transfusions or whatever. What authority do you have now?

Mr. NAYLOR. There is a very limited authority available to the Secretary of Treasury.

Mr. WEAVER. How about the Federal Reserve Board?

Mr. NAYLOR. The Federal Reserve Board does have authority under certain conditions.

Mr. WEAVER. To do what?

Mr. NAYLOR. To purchase system securities.

Mr. WEAVER. So a bailout could occur without legislation, further, additional legislation?

Mr. NAYLOR. It is our view that the legislation is needed both for the systems operations, and then to evaluate whether any additional legislation involving the Federal Government is appropriate. Yes, legislation is needed.

Mr. WEAVER. Legislation is needed? Other members have said—one member said that your testimony is not of your making. You testified, I believe, in response to Mr. Glickman's questions, that there was some form of implied Federal backing. Another member said, "Take this message back to the folks who make the decisions." Don't you believe, Mr. Naylor, that we need the person who can answer these questions here before this subcommittee, that we need Secretary of the Treasury Baker to appear to answer the questions that we have been asking you?

Mr. NAYLOR. Mr. Weaver, I think he would give you the same answers that I am giving you. We need some additional information and we wish to work with the committee, before we can make an assessment of what Federal assistance might be necessary, if any.

Mr. WEAVER. Well, I can only say that I think that I believe, anyway, this subcommittee cannot act without finding a broader view, one, of the financial situation in this country among other financial institutions as well as the Farm Credit System and, two, somebody who has the authority to—and no disrespect of any kind to you, Mr. Secretary—to answer questions. I would say that we really must hear from Secretary Baker and Paul Volker, Chairman of the Federal Reserve Board.

Thank you very much.

Mr. JONES of Tennessee. Thank you, Mr. Weaver.

Dan, is it all right with you for Mr. Evans—he has a question or two——

Mr. GLICKMAN. Sure.

Mr. JONES of Tennessee. Mr. Evans.

Mr. GLICKMAN. I'll be glad to yield to him because he has usually got the best questions.

Mr. EVANS of Iowa. Oh, come on now, Dan.

Thank you, Mr. Chairman.

There is one area that I would like to pursue just a bit further in trying to define the bounds of any legislative package. This authority that you talk about, that would be created to help the system handle its losses and troubled assets, I strongly support that but it seems to me that the administration has been looking at that from the point of view of the overall problems of the system rather than from the problems of the farmer and the problems of the associations; that it is at a much higher level than that.

The experience in Iowa has been, there has been virtually no restructuring of debt within the Farm Credit System at the association level. I don't see that changing under this proposal. I am for your proposal—don't misunderstand me—but it seems to me that it leaves something out, that it would continue the tendency at the association level and at the level where they are working with the farmers, to foreclose or turn that problem loan over to this Capital Corporation and wash their hands of it, and that there is no incentive there to keep it at home. to make it a performing loan to the extent that it can, and to restructure and try to work with that farmer.

Now within the Farmers Home and within the Department last year we went a long way to try to provide for restructuring within the commercial bank system, using the Farmers Home. It seems to me that within the Farm Credit System one can also provide some incentives, within the bounds of the Farm Credit Act, to get them to do that sort of thing at the association level and keep some of these farmers on the land. Of course, one could do it with interest buy-downs and so on. You have ruled that out, and I accept that for the moment as not being acceptable for this package of legislation, but what I am getting at is, there could be strong incentives for that association to stay with this guy and to restructure it, if the legislation provided the Governor an opportunity to give that association, in return for restructuring, a period of time in which to absorb the losses that they are going to have to take.

Now the way you have got it set up, if an association transfers something off to the Capital Corporation, they've got to take a hit for that loss right now, everything that is the difference between the current value and the book value in that association. There is no incentive to do anything else, but we could use that and spread those losses out over several years if that association will work with that guy and try to put part of that package back on a performing basis, and approach it just in much the same manner as you have tried to get the commercial banks to approach it.

Are you philosophically opposed to trying to see what we might do within the Farm Credit Act to increase this incentive to restructure at the association level?

Mr. NAYLOR. Mr. Evans, we are working with the system on that issue. One of the key issues in helping producers is the ability to manage problem loans, and to have some options on how that can be done and still be prudent in their financial operations. One of the major problems in your area has been that without availability of and access to the system's considerable surplus, an individual association that had a high number of problem loans quickly found itself in the position of having several very unpleasant choices. They either freeze the stock, raise the interest rates, or they liquidate en masse. None of those are desirable to them or to us, and we have been working with the system to give them some prudent options to more fairly and reasonably deal with borrowers that are in severe trouble.

Mr. EVANS of Iowa. Well, I would agree with you, and I am not proposing something as a substitute for what you have proposed. I think what you have proposed here is a very important way to give those associations some maneuvering room, but it just seems to me that it overlooks this other thing that we ought to be addressing and could address within the act, and I would like to see some flexibility on the part of the administration in allowing us to explore that in this package, without your violent disapproval going into the game.

Mr. **Naylor**. Mr. Evans, we are discussing with the system some things that can be done with the local associations in that regard. It's part of our own discussions also.

Mr. **Evans** of Iowa. Yes; thank you, Mr. Chairman.

Mr. **Jones** of Tennessee. Thank you very much, Mr. Evans.

Now to Mr. Glickman for his questions.

Mr. **Glickman**. Thank you.

Just two questions: Mr. Naylor, in your summary or prepared statement you talk about the magnitude of projection of the losses in the fourth quarter and the next couple of years. That magnitude is based on "reasonably prudent economic assumptions." Whose assumptions? USDA? OMB? The Farm Credit System?

Mr. **Naylor**. They are based on the general economic projections of the system, using the general economic projections of the Department.

Mr. **Glickman**. So they are the Department's assumptions?

Mr. **Naylor**. On the macroeconomics of agriculture, yes. On the specific loan assumptions, they used the system figures.

Mr. **Glickman**. Have you published those anywhere? Has USDA published those assumptions, that we might take a look at?

Mr. **Naylor**. Mr. Glickman, I assume we have but I don't know that to be the case.

Mr. **Glickman**. Can you find that out? I don't want to pinpoint what those numbers are but I would like to know in writing what your assumptions are that form the basis on which you project——

Mr. **Naylor**. I will ask Mr. Thompson to provide those for you, Mr. Glickman.

Mr. **Glickman**. Last question: I am aware that as of November 1 a court order will be lifted with respect to new foreclosure regulations by your department. For the last 2 years Farmers Home has been very, very restricted in their foreclosure policy. A lot of people think it is because you have been good guys, but in effect it's because a Federal judge has said, "No, no, you can't foreclose."

Now I am aware that you are going to have new foreclosure regulations in place in early November. I am also aware that you are pressing to go public by November 1 with these new regulations, and I want to know just to what extent are you going to get back in the foreclosure markets? You know, to some extent you have been off people's backs for a while. Are you going to get back on their backs now, after November 1?

Mr. **Naylor**. Mr. Glickman, we are going to continue a very prudent and, I think, reasonable policy in that area. We will be very pleased to share that with you and the chairman as soon as we have it completed and ready for publication, and even before. As soon as we have it wrapped up, I would be delighted to discuss it with you.

Mr. **Glickman**. Well, OK. What you're going to do is, are you going to notice these regulations in the Federal Register?

Mr. **Naylor**. We are following the standard regulatory procedure on the notice. We do have an unusual problem in that the judge himself has the right to review and approve them. I would be happy to review that with you in its entirety, or with the committee, and give you a full report on how that is being handled.

Mr. **Glickman.** Well, there has been some relief out there during this period of distress, and I would just hope that whatever the form of the regulations are, that you intend to implement a policy of some restraint in the foreclosure process, regardless of these regulations.

Mr. **Naylor.** We are well aware of the seriousness of the problems being faced by producers, Mr. Glickman, and I think you'll find the guidelines we are developing to be very reasonable and very fair.

Mr. **Glickman.** Thank you, Mr. Chairman.

Mr. **Jones** of Tennessee. Thank you very much, Dan, and thank you, Frank, for the willingness to not only advise Mr. Glickman but this subcommittee about what is going to be published and what the rules and regulations will be before they are published. We do appreciate your cooperation in that regard. It has been mentioned a number of times here while we have had these hearings these 2 days, and I feel a sense of urgency on the part of this subcommittee to be apprised of that before they are put into effect because I, like many other members of this subcommittee, am very thankful for the relief that we have had out there.

I am going to let you go. I appreciate very much the fact that you have been here. We have had you for a long time, about 3 hours, almost a record, I think, for a witness to be questioned, but I know your endurance ability and I don't think that we have damaged you to any great extent. We'll be looking forward to discussing with you the problem at hand. I urge you to continue to be with us in your discussions and also with the Farm Credit System, so we can immediately do something in this year if at all possible.

Thank you very much.

Mr. **Naylor.** Thank you, Mr. Chairman.

Mr. **Jones** of Tennessee. The next witness will be a Member of Congress. Those who may need to leave may do so, and then we will call the subcommittee back to order.

[Recess taken.]

Mr. **Jones** of Tennessee. The subcommittee will resume its sitting.

Mr. Alexander, will you take your seat at the witness table?

Sometime previous to yesterday's and today's hearings we had a session for Members of Congress, and this member was not here and missed an opportunity to be heard. He urged the subcommittee to hear him today. We do have my neighbor, a former member of the Agriculture Committee, here today from a very important agricultural section of the country, the Honorable Bill Alexander from the First District of Arkansas, I do believe.

Bill, we are glad you are here, and you may proceed.

STATEMENT OF HON. BILL ALEXANDER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ARKANSAS

Mr. **Alexander.** Thank you, Mr. Chairman and members of the subcommittee. Mr. Chairman, I would like to submit my testimony for the record, considered as read, and refer to it.

Mr. **Jones** of Tennessee. Without objection, it will be made a part of the record.

Mr. ALEXANDER. Mr. Chairman, first I would like to thank you and the other members for the opportunity to be here today. I was listening to the questions that were asked by members of the committee before I was called to testify, and I would say that for all who listened, they were enlightened by the questions. I would also observe that the answers that were given by the representative of the administration were revealing. I think Mr. Naylor's answers reveal that, without exaggeration, the American farmer faces the worst financial crisis since the Great Depression. The figures of the farmers' financial plight are startling.

Something else I would observe—and it's not in my testimony—is that from the questions and the answers we heard, there is no plan by this Government to make economic conditions better for the farmer. My message to the subcommittee and to the Congress is simple. That is that the Congress must offer a helping hand to the American farmer in whatever form is necessary to get him through this current economic depression.

You know the data, and you have heard it from others, and I will not repeat it nationally but I will say that from the standpoint of my own State there are a few remarks that might be relevant. There are three basic sources of income or credit for the farmers: Farmers Home Administration, the Farm Credit System—which includes PCA's through the intermediate credit bank and the Federal land bank—also the bank for cooperatives, which we don't hear much from any more.

In Arkansas the Farmers Home Administration serves about 55,000 farmers. It lends to about 13,000 of them, which is about 23 percent of the State's farmers. In the First District of Arkansas, the delinquency rate of the Farmers Home Administration today is over 50 percent, and that is after the Farmers Home Administration has tried to close out as many loans as they possibly could over the last 3 or 4 years. The delinquency rate in the State of Arkansas has tripled since 1979.

In regard to the Farm Credit System, the delinquencies in our State have gone up to 571 in 1985 compared to 476 delinquent loans in 1984, and the number of properties that have been acquired by the Farm Credit System have increased from 15 properties, roughly 7,000 acres in 1984, to more than 42 parcels of more than 21,000 acres, a dramatic increase in just 1 year of over 180 percent.

Now the nonaccrual farm credit loans, which are the loans unsecured by real estate, have become delinquent at a more dramatic rate. Just in a 1-year period of time the delinquencies have increased more than 211 percent, over a 200-percent increase in just 1 year.

On the commercial bank side of the farm credit lending situation, the Arkansas State Banking Commissioner, Marlin Jackson from my State, declared last week—just 2 weeks ago—that the State banks in Arkansas are hostage to the farm economy today, and warned that if no action is taken by the Congress, that a crisis will develop in just a short period of time. He pointed out a more than 1,000-percent increase in the number of Arkansas banks under the FDIC problem bank list since last year. In 1980, he said there were four banks that were listed; in 1985 there were over 50 banks.

I would suggest that Congress help the farmer in three ways: one, provide some Federal aid by reduced interest rate loans to farmers; two, provide a program of restructuring farm debt, perhaps as recommended by the administration and by the Farm Credit System itself; and third, Mr. Chairman, I would encourage a policy of understanding by the Congress to add a couple of conditions to this farm aid, this bailout of the Farm Credit System which would provide, one, a homestead exemption for farmers who are threatened with eviction through no fault of their own, and many, many farmers are in this situation. It does the Nation no good to force farmers off the farm. It is extremely difficult for farmers in the middle fifties of their lives to automatically change their way of life and their education in such a way as to acclimate to this type of transition, and I would think a homestead exemption would be appropriate as a condition for the bailout that Congress is considering to provide the Farm Credit System.

I would also encourage the subcommittee, Mr. Chairman, to adopt a form of the amendment which I offered in 1972, together with a fellow named Bob Bergland, of Government-guaranteed loans for commercial banks in order to increase the efficiency of farm credit and in order to increase the scope of farm credit. During a time of austerity, when there is tremendous demand upon the Government to reduce its services, to withdraw its scope of services, to reduce its number of personnel to administer farm loans to the Farmers Home Administration, and so on, it seems to me an opportunity to expand upon the Government-guaranteed loans by commercial banks and that concept, to assist in this period of withdrawal and decline.

The situation is well known to the subcommittee and I will not expand upon the testimony that I have provided, but I for one know that the farm credit crisis is real. It is an emergency, and it forms the basis of a threat to the rest of our country and the rest of our economy if it goes unmet.

I thank the chairman and the members of the subcommittee for your forbearance, and I would be pleased to answer any questions which you might like to pose.

[The prepared statement of Mr. Alexander appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Bill, for your testimony. We will take a good look at what you've had to say here, along with the other testimony that we have had, and I can assure you that we are endeavoring to do something to help this farm situation that we have throughout rural America. We are all vitally concerned with it and we all know how serious it is.

Mr. Evans, do you have questions?

Mr. EVANS of Iowa. I just have one. I want to thank the gentleman for coming today, and his excellent testimony, and focus on one particular point you made, and that is about exempting the farmer's homestead from foreclosure. Some of my staff people who have been working with these people have raised that point with me, but you, I think, are the first one to raise that before this subcommittee, and I'm glad that you have. How would you define, for your purposes, a farmer's homestead?

Mr. ALEXANDER. The homestead?

Mr. EVANS of Iowa. Yes; would you define it as the 40 acres with the buildings, or just the residence, or what do you do about hog confinement facilities and all the kinds of improvements that tend to be lumped together in the context of homestead as it is defined by some people?

Mr. ALEXANDER. Well, Mr. Evans, I think we're going to have to devise a new definition in order to meet a modern need. Certainly as a minimum the farmer's home, that is to say, the home place, the barn, and the immediate premises that make up what is known as the home place in farm vernacular, should be included. Whether or not that is expanded to include the 40 acres is an issue that needs debate and very careful consideration.

I personally don't feel that it is the farmers' fault that they are bankrupt. I think it is a product of Government policy that has produced this situation from a national point of view. It's a national policy and a national problem, and I feel that a liberal construction of an exemption for a temporary period of time is warranted in order to get the farmers through this current crisis.

I would turn from the farm to a home, which is a lot, a parcel, a piece of ground and the home on it, and say that for farmers who are in that situation, that homestead should also include them for a reasonable period of time. I would not say forever, but certainly for a period of 3 to 5 years, possibly even longer depending on the circumstances of restructuring a debt which may in the future provide them with a way out of this dilemma that they face.

Mr. EVANS of Iowa. Thank you for your comments.

I yield back the balance of my time, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Evans.

Bill, I will forgo any questions that I have due to time. We do appreciate your being here. I am where I can ask you anytime I wish, any question that might arise.

Mr. ALEXANDER. We get to talk every week on the airplane. [Laughter.]

Mr. JONES of Tennessee. That's exactly right. Thank you very much for being here with us.

The next panel will consist of the attorneys general from the State of Minnesota, Iowa, and possibly the State of Kansas. I am not sure if Mr. Stephan is here or not. Mr. Humphrey and Mr. Miller, if you gentlemen will take your seats at the witness table and bring anyone else that you would like with you, I yield to a member of this full committee for the purposes of an introduction, Mr. Penny from the State of Minnesota. Mr. Penny.

Mr. PENNY. Thank you, Mr. Chairman. I am proud that there are several Minnesotans who will be testifying this morning.

Mr. JONES of Tennessee. You may introduce them all if you would like to. [Laughter.]

Mr. PENNY. Mr. Humphrey on this panel in the next panel, Cy Carpenter, now the president of the National Farmers Union, but he was president of our State Farmers Union for several years and did an outstanding job. Later in the day you will be hearing from Dr. Barry Casper from Carleton College in Northfield, MN, which is in my district. He has devoted much of his time to the review of this credit and farm crisis situation that we face and to possible solutions.

In particular I want to welcome my good friend, Hubert H. Humphrey III. His name is familiar to all of us here, although his face may not be familiar to my colleagues on this committee, but like his father he is known as a friend of the family farmer, and he has been a leader among attorneys general across the United States in trying to focus on this farm issue. They have collectively put together some recommendations that will offer better due process within the Farm Credit System, and I think that these recommendations are certainly worthy of our committee's consideration.

With that, again I welcome my friend Mr. Humphrey to the subcommittee. Thank you, Mr. Chairman, for yielding to me.

Mr. JONES of Tennessee. Thank you very much, Tim. Now for the purposes of introduction I yield to Mr. Evans of Iowa.

Mr. EVANS of Iowa. Thank you, Mr. Chairman. It is indeed a pleasure to welcome our attorney general, Tom Miller, to this hearing. I have had extensive discussions with him and his staff about their concerns on the handling of farm credit problems. I, too, want to join my colleague Mr. Penny in complimenting the attorneys general in putting together this package. We have the letter to Governor Wilkinson, and I can assure both of you gentlemen that this member is going to pay very close attention to your recommendations. I think they are excellent, and we will have a good, hard look at them as we go through these proceedings.

I yield back, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Evans. I want to join both of my colleagues in welcoming you gentlemen, Mr. Humphrey and Mr. Miller. Mr. Humphrey, your name appears first on the list today, and I believe you are national chairman of the attorneys general of the country or something of that sort. You may proceed.

STATEMENT OF HUBERT H. HUMPHREY III, ATTORNEY GENERAL, STATE OF MINNESOTA

Mr. HUMPHREY. Mr. Chairman, I have talked with my colleague, Attorney General Miller. What we would like to do, if it's all right with the subcommittee, is for us to make our formal comments to the subcommittee, and we would be happy to address any questions with regard to this question together, if that would be appropriate and all right with the subcommittee.

Mr. JONES of Tennessee. Do you have written testimony?

Mr. HUMPHREY. I do have written testimony that has been submitted to the subcommittee.

Mr. JONES of Tennessee. Very good. Without objection, it will be made a part of the record.

Mr. HUMPHREY. Thank you, Mr. Chairman.

My name is Hubert H. Humphrey III, and I want to thank my former State senate colleague, Congressman Tim Penny, for the very kind introductory words that he had. I am attorney general of the State of Minnesota. I also serve as chairman of the Agricultural and Rural Legal Affairs Committee of the National Association of Attorneys General. I am pleased to speak with you today about issues which are of great importance to the farmers of Minnesota and the Nation.

Last month 11 Midwestern attorneys general wrote Farm Credit Administration Governor Wilkinson to tell him about the specific problems which our constituents are experiencing with the Farm Credit System. I think our letter reflects the literally thousands of complaints and concerns that have come to all of our offices from farmers.

Our letter to Governor Wilkinson urged him to reinstate fundamental elements of fairness in the Farm Credit System lending practices. All of the attorneys general have received increasing numbers of complaints regarding a variety of Farm Credit System practices. The letter outlines these complaints in five major categories: Disclosure of loan terms, access to documents and information, fairness and right of review of loan decisions, forbearance, and shareholder rights.

What we are talking about, Mr. Chairman and members of the subcommittee, is basic, fundamental fairness for farmers. It is our position that any financial assistance package provided for the Farm Credit System, any bailout, must be coupled with the requirement that the system implement whatever reforms are necessary to address these complaints. In that regard, Mr. Chairman, we do have specific legislative proposals which I would like to submit to the committee, and would be happy to have the committee take a look at those matters.

Mr. Jones of Tennessee. Without objection.

Mr. Humphrey. One of the most common complaints received by my office concerns the inability of the Farm Credit System borrowers to obtain copies of documents which should readily be available to them.

For example, a farmer in Glencoe, MN, asked her Federal land bank if she could see a file because she wished to begin negotiating for some kind of loan servicing. She was told by a loan officer that she could not see any of the information in her file. It was not until a member of my staff contacted the bank that she was provided with even the most basic information in her file. Even after my office's call, she was still only permitted to see those documents which she had signed herself.

Similarly, a farmer from Lake Benton, MN, wrote his Federal land bank requesting a copy of the bank's bylaws. The bank refused to send him a copy. Again, it was only after intervention from my office that the bank provided the material requested.

It is fundamental that a borrower should have access to the relevant documents governing his loan and that a shareholder should have access to germane corporate documents. Although the Farm Credit Administration has recently recognized in proposed regulations that at least some of this information should be accessible, it must take steps to assure that its member institutions make readily available to borrowers and shareholders all the appropriate information.

In addition, I support regular, thorough audits of local and regional entities within the Farm Credit System by the General Accounting Office or some other agency which Congress may appoint.

Recent developments in the seventh district underscore the need for such scrutiny. Like the parent system, the seventh district last week announced a third quarter loss which substantially exceeded what had earlier been predicted.

However, those indications of fiscal difficulties began to appear much earlier. On May 14 of this year the Federal land banks in the seventh district announced that they were increasing their variable loan rates by three-quarters of a percent, effective June 1. For most farmers, this increase has not been reversed.

The reason given by the land banks for the increase was an increase in their own cost of money, yet at the same time of the three-quarter percent increase, other interest rates were steadily declining. The 6-month Treasury bill rate rose in the first quarter, but fell from 9.4 in March to 7.8 in July. The prime rate fell steadily from 10.75 in January to 9.5 in July. These circumstances demonstrate that there is serious question about the true financial status of individual member institutions, as well as the Farm Credit System as a whole. An objective, accurate, meaningful, and public reporting on these entities is essential to addressing the financial difficulties within the Farm Credit System.

Now the second issue which I will address is that of fundamental fairness for the Farm Credit System borrower—the farmer. There are two principal facets to this issue, Mr. Chairman. The first is the need for the Farm Credit System to give its borrowers ample notice of adverse credit decisions and a right of review of those decisions, and the second is the need for the system to adhere to the letter and spirit of its own regulations.

Fundamental fairness requires that the farmer borrower be given sufficient notice of a potential change in his status to remedy the problem. It also requires that the borrower be provided with meaningful review—by someone other than the original decisionmaker—of any adverse credit decision.

Now neither of these elements is presently a regular part of the farm credit practices. Let me give some examples. A farmer from Dakota County, MN, had a solid payment record with his Production Credit Association for 15 years. Last year he became 1 month delinquent, and received an acceleration notice from the PCA. The notice stated that he had 15 days to pay on his note. However, he received the notice only 3 days before the 15-day period expired. Now surely this is a prime example of woefully inadequate notice.

The good news is, the farmer was able to negotiate a settlement with the PCA which extended the time allowed for repayment, and he promptly brought his payments up to date. The bad news is, simultaneously with the acceleration notice, the PCA also told the farmer that his interest rate would be increased by 2.8 percent because he was now considered a problem borrower. The farmer brought his loan rate up to date and paid the increased amounts through September of this year. He then requested that the PCA review his situation and lower his interest rate to its prior level. The bank refused, telling the farmer that his classification as a problem borrower was indefinite and not reviewable.

Similarly, a farmer from Kandiyohi County, MN, was recently informed that his Production Credit Association had devalued his collateral and classified his loan as uncollectable. This farmer has been with the PCA for 29 years and has always been up to date on his payments. His crop was devalued not because he was delinquent but because he did not have all-peril insurance. However, the farmer had never been informed that all-peril insurance was necessary. He had always been told that hail insurance, which he has, was sufficient. Now, because it is too late for him to get all-peril insurance, he is not able to obtain additional credit from the PCA for harvest. Again, the farmer was told that the lender's decision was not reviewable.

These stories illustrate the need for the fundamental elements of notice and hearing in the Farm Credit System. These elements are basic to our notions of fairplay. In addition, the effect in these situations, as in many others, is to potentially squeeze out the farmer who is still making it today, but who may be forced out unnecessarily if he is not given some objectively reasonable opportunities to continue in operation. This result is inconsistent with the Farm Credit Act, and it is not in the public's best interest, and it is certainly not in the farmers' best interest.

In addition, the Farm Credit System must take care to abide by its own regulations. An issue of particular concern in this regard is the apparent failure of the system lenders to adhere to current regulations and establish appropriate standards regarding the appraisal of land value. While the regulations establish principles of appraisal, the lenders have instead adopted a policy of using benchmark farms to value real estate for the entire State.

For example, Mr. Chairman, we have in Minnesota over 94,000 farms in 87 counties. However, farm credit services in St. Paul uses only 33 benchmark farms in 28 counties to appraise land bank security in the State. It must be seriously questioned whether these benchmark farms are sufficient to assess land values in Minnesota, where over half of the farm real estate debt is held by the Farm Credit System. This issue is particularly important today, as numerous system borrowers are being declared in default, not because they are delinquent on their loan payments, but because their collateral is being rapidly and drastically devalued.

Finally, Mr. Chairman, I would like to comment briefly on the issue of forbearance. I recognize that the farm credit administration has a general statement regarding forbearance in its regulations. I also recognize that the Farm Credit System lenders do from time to time take and make forbearance available to troubled borrowers. However, the system's practice in this area is completely ad hoc.

For example, a local PCA in Minnesota provided the downpayment for a farmer buying property on a contract for deed. A Minnesota Department of Agriculture Program provided the PCA with a 90-percent guarantee on the loan. The farmer kept up his payments, and when it was time for him to seek an operating loan, he went to the PCA. The PCA responded by reevaluating the farm's property, excluding its value with the guarantee. The PCA then gave the farmer an ultimatum: he would receive no operating money unless he would give up his farm and rent.

Now this example illustrates two aspects of forbearance which the Farm Credit System must implement. First, before handing a borrower an ultimatum, the system should provide him with some opportunity to work out his particular difficulty. Second, the system should cooperate with other lenders to help borrowers work out their difficulties.

Mr. Chairman, I understand I am out of time. May I just conclude by saying that I believe that time is of essence; that we are at the end, in Minnesota, nearing the end of the harvest season. People are beginning to think about next season's planting. The farmer, the person who is the borrower, the shareholder of this system, cannot wait any longer for some relief, and we hope that these are constructive alternatives that we have submitted.

[The prepared statement of Mr. Humphrey appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Humphrey, for your very splendid statement. If you will remain, after we hear from Mr. Miller, questions will be offered by members of the subcommittee who are here.

Mr. Miller.

STATEMENT OF TOM MILLER, ATTORNEY GENERAL, STATE OF IOWA

Mr. MILLER. Thank you, Mr. Chairman, and thank you, Congressman Evans, for your nice introduction and the great cooperation that you have given to us on these matters, and the great effort that you are making on the whole farm credit issue. We are proud of your efforts in Iowa.

Perhaps because we are lawyers, the 11 attorneys general in the Midwest on a bipartisan basis—6 Democrats, 5 Republicans—joined together to single out five important areas of procedural fairness, fundamental fairness: make the process fair for farmers in the Farm Credit System.

We addressed things like providing adequate disclosure for farmers when they enter into the loan; that they give an effective annual interest rate so the farmer knows what he is really going to be paying over the term. We also suggest that if they go to a variable interest rate, they have a formula that they tell the farmer is in place that will determine that rate.

We also think that farmers have to be treated right as shareholders, and that when there is trouble within a region or within a part of the system, that if at all possible there be a pro rata reduction of the stock and not a freezing of the stock, because the farmer needs access to that income, that money, in terms of the stock.

These are things that maybe are a little bit abstract. They are procedures. They are due process. They are fundamental fairness, as we call them, but it's important to realize that we are talking about real people here. Let me give you an example.

This example takes place in our State, in the northwest part of our State, in Congressman Bedell's district, Ida County. A farmer there was working with the Farm Credit System and was admittedly somewhat behind on his obligations, but working and working hard, dealing with his loan officer, consulting with his loan officer about the farm operation.

He and the loan officer agreed that he would buy 300 purebred heifers from an outfit in the Western part of the United States, and it was a situation that seemed to be structured very well. The farmer would pay $600 for each heifer, would have it for a year, would feed it, would get some offspring from the heifers, and then would sell it back to the original seller at $1,100, at a profit. It seemed to make sense to everybody. The loan officer said, "Go ahead. Do it. We'll all be better off."

So the farmer went ahead and bought the heifers, then went to the Farm Credit and asked for the money to pay for them. The loan officer said, "Oh, wait a second. You don't get the money unless your folks co-sign." Well, they negotiate over that and they agree that the parents will cosign the obligation for the 300 heifers, but no more. So the parents come in—and the parents had just moved off the farm into the city, the farm they owned—signed the documents, with the understanding that it was just for the obligation to pay for the heifers. They were not given the loan documents. They were given nothing in terms of the important documents when they left.

A month later the farmer came back to get an operating loan to be able to feed the cattle that he had just bought, and they said, "No, we are not going to give you an operating loan. We don't think you are a good risk any more. We are going to accelerate everything," which in pure terms means they are going to foreclose. The parents became concerned about what they signed and they asked for the documents again. No, they wouldn't even give the documents that they signed. Finally they got a copy of them, and what they indicated, pure and simple, was that they cosigned, they obligated themselves to all of their son's debt, not just for the 300 heifers. Foreclosure proceedings now are in place, not only against the farmer but the parents as well.

We don't have to have rules or regulations or hold hearings like this to know that that kind of conduct is wrong. It is unfair, first of all. They shouldn't have had to sign the documents in any case, unless they were told during the decision to get the cattle in the first place. They should have been told what they were signing. They should have gotten copies of what they signed. The farm credit should not have gotten this far into the process without telling him, "We're not going to give you the operating loan." This is just basically wrong, and it has got to stop.

It is not an isolated example, unfortunately. We in Iowa have a farm division in the attorney general's office that is comparable to our consumer protection division, so we hear a lot from farmers when they have problems that are legal-related, and sometimes when they are not, and we hear complaint after complaint after complaint about Farmers Home, about farm credit. In Iowa farm credit lends about 40 percent of the money for land, about 15 percent of the money for operating loans. We get 80 to 90 percent, at least, of our complaints about lenders from farm credit.

Something going on out there is wrong. We wouldn't have that kind of complaint day after day after day about one particular lender, almost to the exclusion of all other lenders. So we checked with other States. We check with Minnesota and found out the same thing; North Dakota, Wisconsin, and most of the farm States of our country that have been experiencing problems, are experiencing this same sort of frustration and unfair treatment from farm credit, so that's why we joined together to come up with what we thought were some basic reforms to this system.

That's why we are here today before this subcommittee, and our message is pretty simple: That whatever you do in terms of the Farm Credit System, in terms of letting them reform themselves, or a bailout, whatever the case is, make sure that farmers are treated fair. Put in amendments that we have advocated, and we would be willing to work on the language. We know that it may not be perfect. We are willing to perfect it with you. Put those in there so farmers are treated fairly, so they have a fair shot in this whole system.

To some extent we have to change not only the regulations and the law, but we have to change the attitudes of the Farm Credit System. Unfortunately, the Farm Credit System is under a great deal of fire. They have a lot of problems, but one of the unfortunate things in terms of this problem situation is that they have lost touch with their mission. Their mission is to help farmers. All too often they view farmers as their adversaries. They don't want to give them the documents. They mislead them, as they did up in Ida County, and that has got to stop. It's not right.

You on this subcommittee can take a major step in terms of stopping that by conveying the message strong and clear to the Farm Credit Administration that that attitude has to stop, and that that language be put into any legislation that you enact. You know, talk about reform, I heard reform earlier mentioned in terms of allocating the money around and greater regulatory authority from here in Washington. That's fine, but this is the real reform that we are talking about.

In closing let me just say that in Iowa we can sense that there is a problem of treatment of farmers by the Farm Credit System; in Minnesota the same thing, and nine other Midwest States. I appeal to you today, and to the farm credit people that are here listening: Attitudes have to be changed. Treatment has to be changed relative to farmers. You are in a position, as they come forward for their other legislation, to make that come about.

Thank you very much.

The CHAIRMAN [acting]. Thank you very much, Attorney General Miller. Thank both of you.

If there is no objection, following the presentation of our two distinguished guests I would ask that a statement submitted by the attorney general of Kansas, the Honorable Robert T. Stephan, be placed in the record.

[The prepared statement of Mr. Stephan follows:]

TESTIMONY OF THE HONORABLE ROBERT T. STEPHAN, ATTORNEY GENERAL OF KANSAS, TO THE CONSERVATION, CREDIT AND RURAL DEVELOPMENT SUBCOMMITTEE OF THE COMMITTEE ON AGRICULTURE, UNITED STATES HOUSE OF REPRESENTATIVES

Mr. Chairman and Members of the Subcommittee:

As Attorney General of Kansas, I am the people's attorney. My role is more specific today as I share the concerns of a group of people engaged in my state's largest industry, agriculture. I am speaking as the farmer's attorney when I bring to your attention the concerns expressed to me through the conversations, telephone calls and letters I have had concerning the practices and policies of Kansas federal land banks and production credit associations, all members of the farm credit system.

At the outset, I wish to make it clear that I do not, as some have done, advocate the abolition of the farm credit system. The farm credit system as established by Congress was intended to serve the special needs of a unique industry, and those needs still exist. However, agriculture is always in a dynamic state, and it is therefore understandable and reasonable to expect that changes in the farm credit system may be necessary to insure that the basic purpose of the system is carried forward in light of today's crisis in agriculture. The objective and purpose of the farm credit system should continue to be, as it has always been, to serve its borrower/stockholders and to aid this country's agricultural producers "by furnishing sound, adequate and constructive credit and closely related services. . . ." 12 U.S.C. §2001(a). In order to fulfill this policy objective, the Farm Credit Act should "continue to encourage farmer and rancher borrowers participation in the management, control and ownership of a permanent system of credit for agriculture which will be responsive to the credit needs of all types of agricultural producers having a basis for credit. . . ." 12 U.S.C. §2001(b). When comparisons between the FCA and commercial banks are made, it is important to remember this language, by which the FCA was entrusted by Congress with a specific role in agricultural finance.

As the chief legal officer of Kansas, I have recently been advised of a number of complaints which have been raised by borrower/shareholders against the Farm Credit Administration and two of its components parts, namely the Federal Land Banks and Production Credit Associations. While these complaints fall into a number of areas (some of which are addressed by other attorneys general who appear as conferees), the most troubling concern in my view is the lack of "forbearance" which the system is showing to some borrower/shareholders who are in financial difficulty now, but who would still be viable producers if given the opportunity to restructure their agricultural operations. While no one denies the existence or the extent of the problems facing the system, it appears that some producers are being taken to foreclosure unnecessarily. This merely adds another element to an already tragic situation.

Farm credit policy has long provided for borrower forbearance before the decision to foreclose is made. Curiously, however, the policy is an informal one, with both the Act and the Code of Federal Regulations silent on the point. The policy of forbearance is informally defined by the Ninth District (Wichita) as follows (this appears to be a representative definition of other districts as well):

> "Forbearance means to reach an agreement with a borrower as determined on a case-by-case basis, to renew, reschedule, defer payment, reamortize, refrain from initiating legal action against a borrower whose loan is in default, or any other option not enumerated that allows the borrower to make payments on the loan."

The policy goes on to say that, in determining whether to grant forbearance to a borrower, the following three conditions should be considered:

(1) Is the borrower cooperative?

(2) Is the borrower making an honest effort to meet the conditions of the loan contract?

(3) Is the borrower capable of working out the debt burden as determined by an appropriate credit analysis of the borrower's present and projected financial condition?

In keeping with this policy, before authorizing any foreclosure action a FLBA or PCA is supposed to consider, on a case-by-case basis, the above conditions for borrower forbearance. In the event the borrower refuses to negotiate in good faith on a plan for forbearance, or the borrower is not capable of working out of the debt burden, the association proceeds to take whatever legal action it deems appropriate to protect the interest of the institution including, but not limited to, foreclosure.

In my experience, by-and-large problems do not exist with borrower/stockholders being unable to fulfill the first two elements or tests for forbearance consideration, namely cooperation and good faith. In fact, the cases brought to my attention demonstrate borrowers trying every possible method and means of preserving their agricultural enterprise. However, while there is generally not a problem with borrower/stockholders being less than cooperative or failing to do all they can to meet their financial commitments, the forbearance policy's third element (i.e. a plan deemed workable by the lending entity) is capable of being so broadly and arbitrarily applied that many deserving borrowers cannot meet its terms, given today's agricultural conditions and the events of the preceding years. Letters from farmers which serve to demonstrate this point are attached.

Based on the letters and complaints I have received, and on the experiences of other state attorneys general, I do not believe that the current forbearance policy is being uniformly applied so as to accurately reflect the intent originally expressed by Congress in the Farm Credit Act. To the contrary, documented cases exist which contain very troubling results. I would suggest that Congress closely examine the policy in a number of respects, with an eye to clarifying and strengthening it.

First and foremost, the forbearance policy is without a provision that grants a borrower/stockholder a means of review in an impartial forum when a forbearance request is denied. In addition, reasons for denial do not have to be expressed in writing, nor do specific terms which support the lender's action have to be given. The borrower is thus left in the dark about the basis for a decision that will probably cost him his livelihood.

In contrast, the Consolidated Farm and Rural Development Act, 7 U.S.C. §1981 et seq., (which is another legislative effort designed to assist agriculture,) provides the basis for a meaningful forbearance policy under the Farmers Home Administration. The forbearance policy in this act (as amended in 1978) provides:

> "In addition to any other authority that the Secretary may have to defer principal and interest and forego foreclosure, the Secretary may permit, at the request of the borrower, the deferral of principal and interest on any outstanding loan made, insured, or held by the Secretary under this chapter, or under the provisions of any other law administered by the Farmers Home Administration, and may forego foreclosure of any such loan, for such period as the Secretary deems necessary upon a showing by the borrower that due to circumstances beyond the borrower's control, the borrower is temporarily unable to continue making payments of such principal and interest

> when due without unduly impairing the standard of living of the borrower. The Secretary may permit interest that accrues during the deferral period on any loan deferred under this section to bear no interest during or after such period. . . ." 7 U.S.C. §1981a.

In finding that this language required the Secretary of Agriculture to implement a formal review upon request, one federal court has stated:

> "Congress intended to create a remedy or permit relief for certain borrowers for whom serious concern had been expressed because of repeated drought conditions and by reason of unusually low farm prices. These conditions created an urgent need and a particular form of relief was devised after extended study and debate. This was §1981a. The section contains the basic eligibility requirement, thus it requires that the applicant make the 'showing' that due to circumstances beyond his or her control 'the borrower is temporarily unable to continue making payments . . . without unduly impairing the standard of

> living of the borrower.' The Act provides that the Secretary may permit 'at the request of the borrower, the deferral. . . .' Thus the relief is only available if requested by the borrower." Matzke v. Block, 732 F.2d 799, 801 (10th Cir. 1984).

The language of the Farmers Home Administration statute reflects the awareness by Congress of the uncertainties that exist in agriculture today, and that circumstances beyond a borrower's control may prevent the possibility of maintaining current payments under the loan obligation. The Farm Credit Act should reflect this same awareness in a formal procedure by which forbearance can be requested (and, if denied, a basis given for the denial), for both laws deal with similar objectives, that being to provide financial assistance to agriculture. While I am not suggesting that the FmHA language be adopted verbatim for the FCA, this does represent a workable model for your consideration. Accordingly, I commend to the Committee the proposed draft legislation in this regard prepared by my fellow attorneys general.

Under current policy, only when an initial loan request is denied or reduced does an applicant have the right to know the reason for such action. 12 C.F.R. §614.4440. He or she may request a hearing by giving written notice to the association within 30 days of the original denial. 12 C.F.R. §614.4441. However, when a borrower/stockholder working under an existing loan becomes delinquent, a letter of foreclosure may be sent without notice or hearing, without regards to a past record of making current payments. Likewise, when a borrower's restructured plan or request for forbearance is denied, no formal hearing process or review is available. As such, the borrower is not afforded a chance to contest denial of forbearance, with the farm credit lender in the position to act as prosecutor, judge and jury. While federal courts have held that such treatment does not violate due process, due to the peculiar nature of the land banks and PCAs as "federal instrumentalities," this type of action offends fundamental notions of equity, and should be addressed by Congress as part of any relief package to the system.

Secondly, the policy of forbearance as currently applied may constitute an alteration of policy so drastic as to constitute a breach of faith with agricultural producers. As noted above, the third element of the forbearance test involves determining whether or not the borrower is capable of working out of the debt burden. This element invites abuses of discretion in the valuation of collateral and the determination of net worth and cash flow. When a land bank forecloses and takes possession of land that has dropped in market value by as much as 50%, the implication is that land will never reach the original loan value again, and that a loss is inevitable.

Such determinations are being made by the very same associations that recently encouraged borrower/stockholders to acquire 85% equity loans on land because they predicted that farmers had not yet seen the top on land prices and that agriculture has not yet begun to assume the debt load it was capable of maintaining. Now there has apparently been a change in the system's philosophy. An aggressive lending position has now become a conservative practice. Unfortunately, borrower/stockholders are not able to quickly reverse decisions and commitments made up to ten years ago when land values were up to three times the current prices. The need for relief is obvious. However, when an association determines the borrower/stockholder is not capable of working out of the debt, the borrower is far too often given no alternative other than foreclosure.

It would appear that in foreclosure no one really wins. The borrower/stockholder loses his land, his farm and a way of life as well as a way to make a living. The lending association is forced to sell land and assets often for a fraction of their loan value, as reflected in today's market price, in which case a significant loss is guaranteed. It would seem that losses could be minimized if in fact the borrower/stockholder was allowed and agreed to stay current in interest and to make payments on principle as conditions allowed. This would give borrowers the potential to continue in business, to restructure their operations and be afforded the chance that farm income levels will rise again so as to allow their debt obligations to be fulfilled. Even in worst case scenario, an association will always be in a position to obtain the land.

In one actual case, a farmer bought land 10 years ago for the market price of $1,000 per acre with the support and encouragement of a federal land bank. Today the market price for the same tract of land is $350 per acre. The farmer is delinquent, as crop prices as well as land prices have steadily declined. While he has attempted to make partial payments, or alternatively has offered to restructure his operations. if anything less than a full payment on both principle and interest is offered by the borrower/stockholder, the land bank has stated its intent to initiate foreclosure. In practical terms, this means the association is certain to suffer at least a $650 dollar per acre loss and the borrower/stockholder will lose the farm which represents both a way to make a living and a way of life.

I do not believe that borrower/stockholders are asking for debt forgiveness, nor do I advocate a moratorium on foreclosures.

However, they are requesting, with justification, some patience, time and cooperation to reschedule and restructure their operations, and for fair and balanced treatment. They are asking for the FCA, an institution that was created to assist agriculture, to live up to that purpose. The system has now come to Congress and asked for assistance. Agriculture needs this system and the system needs your help. However, in giving such help, it is of paramount importance that you do not let the farm credit system lose sight of the purpose for its existence. The current policy of forbearance as applied is often no policy at all in light of the cases which I and other state attorney's general have seen.

In short, Congress is now presented with an unique opportunity to redirect the structure of the farm credit system so that the legislative purpose can again be evidenced by its actions. Many concerned officials of the FCA have expressed the feeling that the answer to the problems in agriculture is not more credit, but more farm income. I could not agree more. Yet this statement does not address the real problems that exist today and that will continue to exist until the time when agricultural income does increase. The solution is not an easy one, nor will it be painless, but the pain can be minimized and should be evenly distributed among the farm credit system, the holders of farm credit bonds, and the farmers and ranchers who comprise the owner/borrower element of this system of agricultural financing. Like the lenders and investors, farmers and ranchers accepted a risk, and again, they are not asking for debt forgiveness. You have to understand the psyche of agriculturalists to know why people ask for the opportunity to stay on their farms for the rest of their lives and still possibly never become debt free. This alone is quite a price to pay. If a fair policy of forbearance cannot be devised to allow them a chance to survive, the result is an enormous injustice that defies the purpose and objective Congress intended when the farm credit system was created by the Farm Credit Act. I ask this body to again act with agricultural producers' best interests in mind, for history has shown this to be our country's best interest as well.

(Attachment is held in the committee files.)

The CHAIRMAN. Are there any questions of our two distinguished guests?

Mr. EVANS of Iowa. If I may, just briefly, Mr. Chairman, I again want to thank the two gentlemen for coming. You mentioned legislative proposals, and you know we are going to be faced with the task of drafting some legislation. I do think we need some assistance from you on specific words that you might recommend. We are going to be hard pressed for time here to handle this, and any assistance you can give us in terms of specific words I think would be very useful. We would encourage you to submit them to committee staff or to individual members, or however you wish to handle it.

Thank you, Mr. Chairman.

Mr. MILLER. We have them with us today, and we will be submitting them to the committee, or whatever is the appropriate vehicle. It's draft legislation. Some of it should be scrutinized very carefully by your staff, and perhaps some changes should be made, which we would be more than happy to work with your staff and with you. I think this is terribly important. Congressmen and members of the subcommittee, we are at your beck and call, as is my staff. Anything we can do on drafting or any other thing, we would be pleased to do.

Mr. HUMPHREY. Mr. Chairman, I would also like to offer the opportunity to work with you from our working group. We do have a number of individuals that come together from each of our offices. They are the people that in many respects have put together the details of our comments and our efforts. We would be happy to work closely with you and offer their services to your committee.

The CHAIRMAN. Thank you very much, sir.

Mr. Penny.

Mr. PENNY. Mr. Chairman, I simply want to thank these two gentlemen for their presentation on behalf of the attorneys general across the Nation. It is particularly helpful that they have put together specific language for this subcommittee. If we could receive the benefit of that kind of specificity from all of our witnesses, it would sure help us in our work around here. I speak particularly in light of the kind of testimony we received by the gentleman just prior to these, by the representative of the USDA, Mr. Naylor.

It baffles me that the administration is still so unable to come to grips with this and unwilling to come forth with specific recommendations to this subcommittee, and yet we have two attorneys general here who have given this a lot of work and put together the kind of language that they would like to see included in the bill. I think it demonstrates a commitment on their part to respond to the rural crisis as best they can from their respective offices, and we continue to get no leadership on this very same issue from the administration, and in particular from the USDA, where these recommendations really must come from.

So, again, I thank you for your testimony and for your specific recommendations. I only wish we had the same kind of leadership and specificity coming from the administration.

The CHAIRMAN. Attorney General Miller, we thank you for your intervention in behalf of farmers and agriculture, and I assure you that your contribution and your battle in their behalf has not gone unnoticed outside of Iowa. We appreciate very much what you do and are trying to do and have done for the agricultural sector and for our producers, not only in Iowa but what you bring us would be for the benefit of all of our producers.

Attorney General Humphrey, what I would like to tell you as an admirer, friend, confidant, and supporter of one Hubert H. Humphrey, you brought us a statement of only four pages on one side. [Laughter.]

Mr. HUMPHREY. I also watched the time, Mr. Chairman, and I know that's absolutely running against the genes of this family.

Mr. MILLER. Somewhat unusual, Mr. Chairman, in regard to this attorney general as well.

The CHAIRMAN. Always we welcome you, and of course your name will forever be legend in the annals of this country. We thank both of you.

Mr. HUMPHREY. Thank you, Mr. Chairman.

Mr. MILLER. Thank you, Mr. Chairman.

The CHAIRMAN. The next panel I am happy to call—we have a vote on the floor, and I don't think it would be fair to call you and then recess, so I will call you at this time, and you know who you are on the next panel: Mr. Cy Carpenter, president of the National Farmers Union; Mr. Rene Niese, treasurer and trust administrator, National Farmers Organization; Mr. Robert Delano, president, American Farm Bureau Federation; and Mr. Ben Morgan, chairman of the board, National Council of Farmer Cooperatives.

I welcome all of you, but I would ask that you kind of stretch or get your thoughts prepared, and the subcommittee will stand in recess for approximately 15 minutes.

[Recess taken.]

Mr. JONES of Tennessee. The subcommittee will resume its sitting.

Mr. Carpenter, would you proceed.

STATEMENT OF CY CARPENTER, PRESIDENT, NATIONAL FARMERS UNION

Mr. CARPENTER. Mr. Chairman and members of the subcommittee, my name is Cy Carpenter and I am president of the National Farmers Union, a general farm organization. I represent the family farmers and rural communities of this Nation. I am always honored to appear before this subcommittee and its distinguished and hard-working chairman. I wish I could say this is a happy occasion. Rather, I appear before you today with a great sense of urgency and concern that unless Congress acts quickly and decisively, hundreds of thousands more of our farm families and banks and small rural businesses will be forced out of business over the next several months.

Let me come straight to the point: What we have in agriculture today is not a credit crisis, it is an income crisis.

I am, quite frankly, disappointed and angry, and I know you are, that we must come together again to plead with the rest of Congress and the administration to realize what is happening in rural America, not only to our farmers and ranchers, but to our rural communities with their small businesses, schools, and churches.

Our entire rural economic and social structure is terminal under present conditions.

Now the economic and social consequences of the depression in rural America have infected the financial community and threaten our entire economy. We have already lost a quarter of a million off-farm jobs because farmers cannot buy the products of input manufacturing.

If farmers and ranchers were getting a decent price for their wheat, corn, cattle, and cotton, there would be no crisis for farmers or their lending institutions. There would be no problem with plummeting land values leading to a collateral problem, no problem with private lenders foreclosing on farms, and no problems with Government lending institutions.

Therefore, National Farmers Union must stand opposed to a—and we hesitate to call it a bailout—refinancing or underwriting for the Farm Credit System and other lenders, unless that plan also provides for restoring income to farm families so they can repay their debts. Without the ability for farmers to repay those debts, any refinancing could at best be only temporary, and would eventually destroy the Farm Credit System.

The answer to this crisis is fair prices to farmers on their commodities—the same remedy which rescued the farm credit structure when it was undermined by low farm prices in the early 1920's and again in the early 1930's. There was Federal help in each instance, but the dramatic recovery of farm prices and income was what enabled the farm credit operation to become viable again.

Now, in 1985, the situation of the Farm Credit System is more precarious, while the farm price rallies which turned the tide in the twenties and thirties are nowhere in sight. What we face is not the hope of recovery, but the reality of a steep decline in prices and income.

We are not interested in bailing out the nonfarm investor in the Farm Credit System at the expense of the farmer-cooperator. The farmer is also an investor in the Farm Credit System—farmers have over $5 billion of their own capital in it. If the Farm Credit System is to be revitalized by additional funding, the farmer and his cooperative will carry the whole load of repayment.

National Farmers Union is totally supportive of the important role the Farm Credit System has played and will, we hope, play in the future of family farm agriculture. We are equally supportive of corrective action to solve the current problems by providing farm income and the additional availability of funds to the Farm Credit System as necessary. Let me stress that there is nothing fundamentally wrong with the Farm Credit System which would not be cured by a return to realistic farm prices and income.

With the following conditions before agriculture today, what lending institution—private, cooperative, or Federal—could realistically provide credit to farmers without hope that they could earn an income to repay it? The answer, of course, is none.

Just a few observations about the true conditions facing today's agriculture and its lending institutions: Prices received by farmers for most major commodities are running 20 to 25 percent below a year ago. Prices are forecast to be even lower in 1986.

Net farm income for 1985 is forecast between $23 and $27 billion, compared to $34-plus billion in 1984, and the effect of that reduced income has not yet been demonstrated.

Farmers' return on equity will be negative for the fifth consecutive year in 1985, and may run a minus 20 percent or more.

Exports of farm commodities are forecast at $32 billion, nearly 16 percent below 1984. Volume is expected to be off another 10 percent the next year.

Land values are off in many Midwestern States by more than 20 percent from the previous year, and about half the value that they had 5 years ago.

Now we recognize the fact that if we are to keep a substantial number of farmers in business, some emergency action by the Congress, the administration, and the lending institutions will be necessary. Even if Congress were to pass the best possible farm bill this year, the price and income provisions of that bill would not be effective until the middle of next year, and that would be too late for many farmers.

As it stands now, the farm bill currently working its way through the congressional process is not adequate to improve farm income, and the rural depression will worsen.

Recognizing the need for emergency action, however, is not a blanket endorsement of a simple bailout of the lending institutions, cooperative or private. We will question any measure that simply, and only temporarily, bails out the lending institutions and leaves the farmers with declining income and no prospect of improvement in commodity prices and income. What good will a simple bailout do if farmers cannot repay their existing debts?

The fact is that unless there is a turnaround on the income front, things will be worse next year and an even bigger bailout will be needed. The longer farm price recovery is delayed, the costlier any bailout will be. Today's $5 to $10 billion bailout will double by next March and double again by next October if nothing is done about farm income. Instead of improving farm income, the 1985 farm bill, as it now stands, is likely to reduce it by about 20 percent in the next 3 years. No one should be surprised when a $20 billion bailout is needed in March or a $40 billion bailout is needed at a future time. National policy is inviting exactly those results.

Now since that is such a variance from what Mr. Naylor testified on behalf of the administration, and since a bailout will not help a single farmer with respect to his individual loan, we are ready to let the truth unfold and demonstrate what will happen out there, and let the administration convince the commercial lenders, the financial institutions, the money markets and the rest, of the fact that it will recover by itself by 1988.

In my testimony I mention, Mr. Chairman, the expanding conditions where land foreclosed is resold under what we think are very adverse conditions. I will not expand on that because I have provided you a report on that to review, and Governor Branstad mentioned it to some extent, but we do believe that in dealing with this you need to investigate that situation because it invites outside investment, speculative ownership of land, and is certainly a discredit to the present borrowers and supporters of the Farm Credit System.

The sad part of all this is that we need not be in this situation. We, along with other responsible organizations, saw what was about to happen if the administration went ahead and implemented its farm policy. Even though the Congress gave the administration ample authority to implement supply management programs, to eliminate burdensome production levels while providing food for our Nation and other hungry people of the world, they chose to implement the law only to the degree absolutely necessary to comply with congressional mandates. As a result, inventories of all basic commodities continue to increase. It was no secret what was about to happen.

On May 18, 1982, before a special meeting of the Committee on Agriculture, National Farmers Union presented its report, "Depression in Rural America." At that time we presented the Congress the facts of what was already happening in the rural economy and the community, and accurately predicted the course of events that has come to pass. I want to compliment you, Mr. Chairman, and Chairman de la Garza for recognizing and giving us that opportunity at that time.

I see that my time has—well, I have a little more time but it is rapidly expiring. I want to make one final point, and that is, because the farm lending crisis grows more serious each day, and since the last quarterly review of the Farm Credit System's finances shows a $500 million loss, with projections of a $3 billion loss through 1987. The situation is deteriorating so rapidly that it demands emergency steps be taken.

We ask that you call for an immediate halt to all foreclosures or liquidations by the Farm Credit System, by the FmHA or other Government lenders, until a solution can be worked out. I reiterate, Mr. Chairman, that all of these measures will be to no avail unless the basic underlying problem is addressed—an adequate price for farm products and income for farmers, in order that they can repay their obligations.

I thank you for the opportunity to appear before your subcommittee.

[The prepared statement of Mr. Carpenter appears at the conclusion of hearing.]

Mr. **Jones** of Tennessee. Thank you very much, Mr. Carpenter. Although you may not have gone through the entire statement, it will all be made a part of the record, without objection. We will come back to you at a later time for questions, if you will remain where you are.

The next witness is Mr. Rene Niese, treasurer and trust administrator of the National Farmers Organization of Corning, IA. Welcome, Mr. Niese; we are delighted that you are here.

STATEMENT OF RENE E. NIESE, TREASURER AND TRUST ADMINISTRATOR, NATIONAL FARMERS ORGANIZATION

Mr. **Niese**. Thank you, Mr. Chairman and members of the subcommittee. It's a pleasure to be here this afternoon. First let me thank you for arranging this hearing and providing time for us to appear before you today.

For the record, my name is Rene Niese. I am the treasurer, chief financial officer, and trust administrator of the National Farmers Organization. I am the one that is responsible for the organization's financial assets, and one who is in daily communication with our members and with business people who deal with farmers. I come before you with some understanding of the complexity of the problems within the farm credit field and a feeling of heavy responsibility to convey that concern.

Mr. DeVon Woodland, our national president, farmer and rancher from Blackfoot, ID, had made plans to be here because he recognized the dire credit circumstances prevailing throughout most farm communities of the United States. He has asked me to bring his personal greetings, explain that unavoidable circumstances forced him to return to his ranch in Idaho this week, and to present our views.

I will not take up the valuable time of this subcommittee with the statistics that you are already aware of, and familiar with, that support the serious circumstances that exist in rural America and within the Farm Credit System today, although it is included in the written testimony submitted to the subcommittee here this afternoon. On February 7, 1985, our Washington office director, in an appearance before your subcommittee, emphasized how rapidly our farm credit structure was approaching a crisis. We called for expansion of the Farmers Home Administration direct loan program and an interest buy-down for reliable producers in the midrange size of operation. We also urged you to put a stop order on FmHA foreclosures for a reasonable period of time.

As we look back over this year, we are convinced of the validity of those viewpoints. You did initiate action in Congress, and we thank you for that quick response, but you were frustrated by the administration's veto of your legislation. The administrators of the Farmers Home Administration Program may have let up somewhat on foreclosure actions, but the feeling running throughout farm communities has moved from one of dissatisfaction and concern to an attitude of despair.

Many people have become so discouraged that they have grown very quiet. They come to our meetings to talk about bargaining, prices, interest rates, and other related concerns, but they began to express a lack of confidence that Washington is going to help. The feeling is one of concern by producers who agonize over proper or prudent management decisions within their own operations, without affecting their credit relationship with their existing borrower.

If you decide to take action on the Farm Credit System, our suggestion to you, Mr. Chairman, and to the subcommittee, would be don't bail out the investors and financial institutions unless you are going to strengthen the cash-flow for the individual owner-operators in the midrange farming entity.

We ask you to consider the need to support farm income. For example, by increasing price supports but stay in the budget by denying entry to the farm program to foreign investors and institutions whose main business is other than farming. You could insist on cross-compliance and strong administrative actions to clean up program administration. You could restrict importation of competitive farm products coming out of subsidized farming in other countries, such as pork and casein. You could reverse the recent decline in the administration of the Federal grain standards that influence our grain exports.

This is by no means a complete or well-organized set of corrections for the farm bill currently moving through Congress. We are trying to illustrate, however, that something worthwhile must be done about farm income if we are ever going to reduce the credit dilemma to manageable proportions.

Keep control of any reorganization of the Farm Credit System. Although we must acknowledge that information made available in recent months would justify a change in authority and management, we warn against complete loss of touch with the farming community at the level of control necessary to unify sound operational policies throughout the country. What we are really trying to say is, we do not need to lose producer involvement and producer participation in that program.

We suggest that the system has become ingrown and self-serving in some districts, and any reorganized central authority must have producer representation.

In order to meet the obvious urgency of aiding the whole Farm Credit System, action must be taken soon. We suggest that it would be best to report a two-part bill. Deal with the Farm Credit System by underwriting bonds in the money market, and extend an improved and enlarged guaranteed loan opportunity through the FmHA. It probably will be necessary to move with a combination of stronger direct loan action and a modified guaranteed loan arrangement containing an interest buy-down feature. It is not unreasonable to ask banks to reduce interest rates by 2 percentage points, while offering another matching 2 percent cut from Federal funds to encourage private banks to carry clearly qualified farm borrowers who can survive with such an arrangement but who are otherwise going under.

A parallel action should authorize and direct the Farmers Home Administration to assume some land loans now carried by the banks where the producer is well-qualified and the bank will discount the loan rather than push a foreclosure and a sale on the land at current price levels, which are already depressed. In this case the producer must be relieved of the loan obligation proportionate to the discount.

And, most importantly, in behalf of producers we recommend that you undertake to establish certain priorities to be observed in the administration of any reorganized credit arrangement resulting from new legislation.

First, regardless of whether a borrower is in the Farm Credit System, the FmHA group, or is serviced by private banks utilizing the guaranteed loan feature, first consideration should be given to financing and permitting a present borrower to stay on the land, if the family is capable, hard working, and making an effort to meet their financial obligations.

Second, in the leasing or sale of land that has or will come into the possession of one of the agencies, every effort must be made to place that land with an individual midrange owner-operator that now is a family farmer, working together as a unit.

Third, a reasonable balance among agencies an institutions as to the availability of credit should be maintained. In other words, this credit crisis should not be permitted to change substantially the proportion or the balance of farm credit carried by the Farm Credit System, the Farmers Home Administration, and private banks if such a shift can be avoided.

To summarize, in this brief presentation we have concentrated on the need for increased net farm income—which is the real cause and the real problem that we face—revitalization of the credit agencies serving farmers and what may be done legislatively to correct some grievous policy directions of the past. Perhaps it would also be well to think of the possibility of positive accomplishment that may come out of the price and credit crisis. We have nearly lost the family farm system that has proven to be so successful in the past and served as an important part of our heritage throughout our history.

In the placement of properties that they now own or those coming into their possession in the near future, the credit agencies would do well to search for young family farmers capable of making a new start in farming. To accomplish such a goal, local leaders in the credit institutions will have to make and take the initiative. Many of the judgments and decisions will be subjective in nature, and this may involve some risk. Nevertheless, we harbor the hope that the farm economy can be turned around.

When that occurs, we would like to think that those who will control the land, the small business houses, and the future of community affairs in rural America will be the people with longstanding interests in those communities. We will have little faith in a total system based upon absentee ownership and a large, floating tenant population whose commitments can only be of a short-term nature. Most of our ancestors came here to get away from that system. As an organization, we resent the old system following us here and now destroying the very communities that are such an important part of America. We built them and we want to keep them, and we think that is in the country's best interests.

Mr. Chairman, again we thank you and the members of this subcommittee for the opportunity to present our views, and we hope to work with you if a bill is forthcoming. Thank you.

[The prepared statement of Mr. Niese appears at the conclusion of the hearing.]

Mr. WEAVER [acting chairman]. Thank you, Mr. Niese. We appreciate your testimony.

Mr. Delano.

STATEMENT OF ROBERT B. DELANO, PRESIDENT, AMERICAN FARM BUREAU FEDERATION

Mr. DELANO. Thank you, Mr. Chairman. My name is Robert B. Delano, and I am an active farmer and also serve as president of the American Farm Bureau Federation, the Nation's largest farm organization.

The events of the last several years have made credit issues of prime importance to the Farm Bureau. As you may recall, we were involved in the Debt Adjustment Program in September 1984 and the proposal to advance price support loans to assist in financing the 1985 crops. Our first concerns are for farmers. That is not to say that we will ignore the problems of lenders, but we will first look at the impact any program has on agricultural producers.

We must arrive at solutions which truly help farmers and ranchers, and at the same time, ensure the integrity of the financial systems serving farmers. The effort will fail if we save farmers but lose the local financial institutions which farmers depend on. Likewise, if we save the financial systems in such a way that they no longer serve the best interests of farmers, we have also failed. The eventual steps taken by the Congress and the financial institutions will be very critical to the future prosperity and income opportunities for all of agriculture.

Much recent attention—and even today, particularly—has been focused on the Farm Credit System and its deepening financial difficulties. The debt problem in agriculture is much wider than just the Farm Credit System. The system has only about one-third, maybe a little over, of the outstanding agricultural debt. Many farm bureau members rely on local banks, farm suppliers, insurance companies, and individuals for credit. Any credit assistance programs must be balanced among all lenders, not just the Farm Credit System.

Any actions on credit that Congress might take must recognize that the expansion of debt that occurred from 1972 to 1982 cannot be handled based on the expected income over the next few years. Some segments of agriculture are simply carrying too much debt in relation to the earning power of the assets they control. No program will succeed unless the debtload is reduced for the one-third of the commercial farm operators that hold two-thirds of the commercial farm debt.

These producers are carrying a debtload that cannot be serviced based on likely farm income over the next several years. Another low-cost loan that increases debtload, or an interest subsidy for a year or two will not provide a long-term solution. Their debtload must be reduced so it is more in line with potential earning power of the underlying assets.

This is not to say that the two-thirds of family operators with one-third of the debt should be ignored, but rather that the one-third has the most severe difficulties. All farmers will benefit from efforts to lessen the burden on farm credit institutions. Care must be taken to ensure that the positions of the other two-thirds are not weakened by policies aimed at the one-third in worst shape.

Any plan put forth will not prevent financial losses for farmers, lenders, and taxpayers. Since farmers and lenders were the creators of the debt, solutions must involve those same producers and lenders. Government assistance to either producers or lenders should be structured to ease the financial adjustments that must take place and, as I said earlier, adjustments of debt to earning power must occur.

The first instinct of many people is to hastily enact a program or a series of programs. Since actions taken will have a major, long-term impact on agriculture, the utmost care must be taken to ensure that the actions taken now do not cause more problems in a year or two from now. There continues to be a great amount of dispute about the true financial situation of the Farm Credit System, banks and other lenders. These discrepancies must be cleared up before decisive action can be taken.

Likewise, there is considerable dispute about the amount of debt held by farm operators. Most people have accepted USDA's estimate that total agricultural debt was $213 billion on January 1, 1985, yet another USDA study showed farm operator debt at about $120 billion on January 1, 1985. These huge differences in estimates of debt load cannot be dismissed lightly. The figures indicate that some people who are not farm operators either have borrowed money to purchase agricultural assets or have used agricultural assets as collateral to borrow for nonfarming purposes. Our concern centers on agricultural producers, not on these other people who may have nonfarm income that allows them to manage this debt.

Mr. Chairman, the farm bureau is very interested in the impact on farmers of any policy solution to the debt problem. We are concerned that the real issue of too much debtload relative to ability to pay be kept separate from other issues. We want to make sure that the facts pertinent to policy solutions are clearly defined before actions are taken. And, finally, we want to make sure that any solution maintains the delicate competitive balance that exists among all farm lenders. Farmers surely want to avoid becoming dependent on one source of credit.

In conclusion, Mr. Chairman, we are very aware of the farmers' current financial situation. Like Congress, which must deal with this complex issue, we find at this time that there are more questions about, than solutions for, our debt and credit problems. Farm bureau looks forward to working with the subcommittee in developing solutions to these farm debt and credit problems.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Delano appears at the conclusion of the hearing.]

Mr. WEAVER [acting chairman]. Thank you, Mr. Delano.

Mr. Morgan, please.

STATEMENT OF BEN F. MORGAN, EXECUTIVE VICE PRESIDENT AND CHIEF EXECUTIVE OFFICER, DAIRYMEN, INC., AND CHAIRMAN OF THE BOARD, NATIONAL COUNCIL OF FARMER COOPERATIVES

Mr. MORGAN. Mr. Chairman, members of the subcommittee, I am Ben Morgan, chief executive officer of Dairymen, Inc. and chairman of the board of the National Council of Farmer Cooperatives. I appear before you today on behalf of the nearly 6,000 local farmer cooperatives represented by the national council and their nearly 2 million farmer members.

These local cooperatives are part of the Farm Credit System in two ways. First, their farmer-owners have borrowed from the system for their farming operations. Second, the cooperatives have borrowed and hold stock in the system.

In 1984 the largest 100-farmer cooperatives had nearly $500 million invested the banks for cooperatives. At the same time, over one-half of the $6.4 billion of these cooperatives' debt came from the banks for cooperatives. This underscores our basis for concern and support for appropriate and necessary actions to address the financial problems faced by our farmers.

Our primary concern is the financial health of our farmer members, for if farmers are having problems, then cooperatives are having problems. If the Farm Credit System is forced to charge higher interest rates, freeze stock or increase foreclosure rates, then everyone is impacted. The farmer is not only impacted in his own financial arrangements but in his reduced benefits or earnings as a member of the cooperative. Higher interest rates would not only increase the farmer's interest expense, but also reduce his earnings from the cooperatives because of the higher interest charges. The farmer is paying twice.

These are difficult times for farmers and their cooperatives. Few sectors of the economy have experienced such a rapid reversal in economic fortunes as has occurred in agriculture in the 1980's.

The impacts are not confined only to farmers or their cooperatives. Among the input industries, we find farm machinery plant operations scaled back to less than half of capacity. The fertilizer industry is using less than three-fourths of its capacity and the transportation, processing, and marketing sectors have about one-fifth of their capacity unused. This represents lost jobs and income to the local communities that make up rural America.

There are a number of complicated and related factors which have contributed to the current state of agriculture, including economic recession, an overvalued dollar, Third World debt, unfair trade practices, and past embargoes. But the issue is, where do we go from here?

I believe we are making progress. I wish to commend this committee and the House of Representatives for its approval of a 1985 farm bill. This, I believe, recognizes the current problems of agriculture and attempts to provide the support necessary to return profitability to farming.

This measure is designed to stabilize the drop in farm income, and hopefully, lay the foundation for future recovery in terms of export markets and farm income. However, in the near term we must recognize the fact that agriculture is experiencing a massive decapitalization. This, in turn, is undermining income stabilization efforts and the viability of the agricultural lending institutions. This leads to a further deterioration in the financial condition of agriculture.

The next 12 to 24 months will be increasingly difficult for farmers and those providing financing. If land values continue to decline or fall sharply, the equity of otherwise sound farm operators will be greatly reduced. This could lead to an increase in the size of loan writeoffs and the magnitude of the financial problem. Therefore, it is essential to restore stability to farmland values and assure credit availability to American agriculture at reasonable rates.

The Farm Credit System, dedicated exclusively to an industry that is facing continued erosion in real income and massive asset devaluation, cannot continue to absorb the financial consequences. The system holds about one-third of the total farm debt and 48 percent of the farm real estate debt. Increasing interest rates to generate earnings in the face of mounting losses will drive farmers who are currently trying to refinance toward bankruptcy at an accelerating rate.

For those who can refinance, these same higher rates are driving those farmers to other lenders. Other farmer capital flees the system out of fear that their stock investment will be lost. The result is a downward spiral in the confidence and capital base in the system as a whole. This is true not only for farmers but their cooperatives who depend on the system as a vital source of credit.

The National Council of Farmer Cooperatives supports the proposal of the Farm Credit System and views it as an integral component of a comprehensive and balanced approach to restoring profitability to agriculture. We look forward to working with you, Mr. Chairman, and the subcommittee in a continued effort to address the very real problems confronting agriculture.

Thank you very much.

[The prepared statement of Mr. Morgan appears at the conclusion of the hearing.]

Mr. **Weaver**. Thank you, Mr. Morgan.

I would like to ask one question of all of you: If you were members of this subcommittee, would you vote for funds from the U.S. Treasury to the Farm Credit System, without any provisions to enable the farmer to increase his income? Mr. Carpenter.

Mr. **Carpenter**. As I said in our testimony, we would oppose action that would simply bail out the Farm Credit System without parallel efforts or parallel action to improve farm income.

Mr. **Weaver**. Thank you, Mr. Carpenter. That's a very good answer.

Mr. Niese.

Mr. **Niese**. We would be in support of any effort that would support income to the farmer, but without it you find yourself in a vicious circle whereby the process repeats itself once the extension of credit is given.

Mr. **Weaver**. I don't understand why everyone else can't see that, Mr. Niese. That's very clear. If you don't increase the income ability of the borrower, then pumping money into the credit system is going to do no good whatsoever. The loans are still bad.

Mr. Delano.

Mr. **Delano**. First, I don't particularly agree with the term bailout. I think a loan of some type would be a more favorable type of term to use, rather than a bailout.

Mr. **Weaver**. Forgive me. Let's call it a loan or a credit line.

Mr. **Delano**. And I would certainly agree that increased income is a necessity in agriculture.

Mr. **Weaver**. How would you vote, if you were a member of this subcommittee?

Mr. **Delano**. Relative to——

Mr. **Weaver**. If you were asked to vote for a bill that provided funds from the U.S. Treasury to the Farm Credit System without any provisions of any kind to enhance farmer income, how would you vote?

Mr. **Delano**. Well, I don't know how I would vote. They are two separate issues, to me. They are separate issues, as we look at the legislation that has been submitted here. If you are going to tie the two together, I would vote that we would have to have a type of farm bill similar to the one that has been adopted by the House, that provides some income enhancement over a period of time, in order to keep that money in agriculture. So I would vote for the loan, a loan to the Farm Credit System, if it has to be tied with the farm bill.

Mr. **Weaver**. Mr. Morgan.

Mr. **Morgan**. Mr. Chairman, in my statement I commended this committee for the action they have taken in passing the 1985 farm bill, which I stated I believed would certainly slow down the decrease in income and enhance income, as we do have an income problem as well as a credit problem. Likewise, I point out and urge that this credit situation is immediate. It needs immediate action and certainly I would vote, if I was only committed, to take action on this as soon as possible because it's getting worse in an accelerated way.

Mr. **Weaver**. All right. Thank you very much. We have two votes aye and two votes no, and the measure fails.

The gentleman from Kansas.

Mr. **Glickman**. Thank you, Mr. Chairman.

First of all, I want to tell you I appreciate your testimony. All of your organizations provide useful input into this committee.

Mr. Delano, I would like to focus for a moment on your testimony. To be honest with you, it is kind of fuzzy. I am not quite clear where the Farm Bureau stands with respect to farm credit legislation in terms of both—and I like the way you refer to the fact this is not a bailout. I think there has been too much reference to the word bailout, and I think that's an incorrect characterization. But I'm not sure of your formal testimony, if you are for Federal assistance or if you are against Federal assistance, if you are for restructuring the Farm Credit System or if you are against restructuring the Farm Credit System. You are the largest farm organization in the United States. Your organization has more farmer members in my State than any other organization, and I would like to know where you stand on these things.

Mr. **Delano**. Mr. Congressman, one of the reasons that my statement is fuzzy, as you indicate, is because we have a committee that is working on studying the farm credit situation in the country today—the Farm Credit System, the rural banking, and any credit or lending institution. We don't have a position on a given point right now, and that's why my statement is fuzzy, I guess, as you say. We have some questions, still, that haven't been answered.

As I indicated in my testimony, we're talking about $212 or $213 billion owed by agriculture, yet a farmer-operator survey says that they owe $120 billion. Who owes that other money? Is it absentee landlords or who? We think we should have some answers as to who owes that other money. It's conceivable in my mind—and, again, this is a personal opinion—that it might be that agriculture could service $120 billion but there is no way, with present prices, and it looks like, future prices in the next few years, that it can service $212 billion, but who owes that difference in between?

I have come to the conclusion that someone has to write off some of this debt, and maybe up to $50 billion, because there is no way that agriculture can service this amount of debt with the present prices.

Mr. GLICKMAN. Who do you think ought to write off the debt, if it has to be written off?

Mr. DELANO. Well, I think the lending institutions have to write off some of it. Really, I don't know who else would write it off unless the Government would come in and write off some of this, and I think the Farm Credit System should write off some of theirs, as other commercial lending institutions.

Mr. GLICKMAN. OK. Well, I only make the point because you are an influential organization. Your organization particularly has great influence, I think, on this administration. Implicit in your earlier response to Mr. Weaver's question is that you would support some sort of cash infusion somewhere down the line. There is not much time left to at least explore this problem in great depth and I would encourage you to, so to speak, get your act together as quickly as possible. I think it's important for us. It's true of all the other organizations, but inasmuch as your organization has close ties with the administration, I think it's most important.

I would like to ask one other question—Mr. Stenholm referred to this before—and again to you, Mr. Delano. It has to do with budget issues and Gramm-Rudman. I've got this Farm Bureau "Farm Leader Letter" in my hands. This is from the Kansas Farm Bureau but I am going to presume that a lot of the information comes from the national office, and it talks about the Gramm-Rudman-Hollings proposal to legislate a balanced budget. Then it says, "Delano has notified members of the conference committee considering balanced budget legislation that the Gramm-Rudman-Hollings proposal offers the best opportunity at this time to move the Federal Government toward fiscal responsibility."

Now I am not going to take words away from Mr. Stenholm. He does plenty well himself but, as he was talking a little bit earlier, Gramm-Rudman-Hollings, if passed, will probably require very significant cuts in agriculture programs, both in terms of farm income support programs as well as any inability to deal with the Farm Credit System. I just want to warn you that if you are onboard all the way with Gramm-Rudman-Hollings, it may come back to bite you, at least in the short term.

I wonder if you have any response to that?

Mr. DELANO. Well, first I would rather have a constitutional amendment that would require a balanced budget. That's No. 1, and we have been working with States to get the 33d and the 34th State. Second, as we look at the Gramm-Rudman proposal, it looks like the newest kid on the block and it looks like the best kid that we have now to ride with. That has been our rationale in supporting it. It is an attempt, and I think an honest attempt, to balance the budget sometime in the near future. I realize that I think everyone has to take their fair share of the cuts if this is implemented.

Mr. GLICKMAN. I guess my only point is that if the farm situation is in particular distress now, that one could argue over the long term it is in the interests of farmers to deal with the budget like this, but you will probably intensify the distress in the short term.

I just think you ought to think about that, as well, as we need to during the next few days.

Mr. **Delano**. Yes, sir.

Mr. **Weaver**. The gentleman's time has expired.

The gentleman from Wisconsin.

Mr. **Gunderson**. Thank you, Mr. Chairman, and thank you to all of you gentlemen. I hope you recognize the importance, and I would suggest, the burden that each of you carries as representatives of your farm organizations, the major farm organizations in this country, on this most important issue.

I have listened very closely to all the testimony, and I have to find it rather ironical that Ben Morgan of Dairymen, Inc., and I agree the most. I thought your statement was clearly the most helpful to this subcommittee, because you had the courage to come out and say you either supported it or didn't. I am not totally critical of the Farm Bureau for waiting on this. I understand that anyone is hesitant to come out in support of a plan until you know the details of it.

I would encourage you, however, to come up with a more definitive statement in the very near future. If this committee, if this Congress is going to act on this issue, we have got to act on it very, very quickly, this subcommittee especially, to get the process rolling.

I can't resist the temptation, Bob. You talk about the real need is increased farm income, and I must encourage you, with a number of my dairy colleagues who I see in the room today, that if you want to help us increase farm income, reconsider your position in opposition to the dairy diversion. If you want increased income for dairy farmers, you are going to have to have that diversion program. Price cuts aren't going to solve the credit or income problems. I encourage you to consider that along that line.

The one I have the most trouble with, in all due respect, is the Farmers Union position. You know, in August I went home to my district, and I had some farmers who came in and said, "Give us heaven on Earth in a farm bill." There were some pretty heated meetings and I said,

> You know, I can do two things in Washington. I can go there and I can pose for holy pictures, make some wonderful political rhetoric, or I can go there and I can try to be responsible and do the best I can to get the best program that has a chance of getting passed, passed.

Now to suggest that we can somehow, in a bill dealing with the Farm Credit System, automatically increase farm income in this country, is naive, and everybody in this room knows it. That is the debate on the farm bill. You can either support or oppose the farm bill. We are not going to solve the farm income problem here, and we are not going to solve the universal farm credit problem here because if we get into commercial banks, we are going to lose jurisdiction.

I would just like to read to you what is said by Chase Econometrics, if we let the Farm Credit System go downhill: It would mean that almost 90,000 additional farm operators would have their loans foreclosed in the first year after default on the system. Interest rates paid by farmers likely would increase by 3.5 to 4.5 percent, and there likely would be a $20 to $40 billion credit shortfall to meet agricultural production expenses.

Now, gentlemen, we don't have the luxury of picking out the ideal. We have got to deal with the realities of the time, the realities of the environment, with the realities of the options that are in front of us. I guess I have got to ask you again, Cy, are you really telling us that we ought to let the Farm Credit System go under?

Mr. CARPENTER. Congressman Gunderson, I couldn't be more clear in saying that that is a consideration in the face of the total picture that deserves support. You talk about the importance, and I'm glad you referred to Chase Econometrics. I think Mr. Naylor and others need to look at the same statistics. You talk about the drastic prediction coming from that kind of a careful analytical study.

Now I think you need to weigh that against what is already happening to farmers. They are taking a $4 billion per month write-down in property for 40 months. They are losing farms that had been in the family for 100 years. Their income is less than enough to pay the interest on their debt.

Mr. GUNDERSON. Cy, I know all that.

Mr. CARPENTER. I understand.

Mr. GUNDERSON. I've got them in my district. What do you want us to do about it in terms of credit?

Mr. CARPENTER. I am saying that if perhaps the financial community, including the investor that we have been talking about, has to write down $4 or $6 or $10 billion, they will be supportive of farm legislation which is not separated and cannot be separated, which is the only real solution to the Farm Credit System.

Mr. GUNDERSON. Yesterday, when we heard the first day of testimony on this issue—and your people were here, if you were not—the Farm Credit System indicated that they have guaranteed in the sale of those bonds that those bonds would be protected to the purchasers. They don't have the luxury, we don't have the luxury, of telling the investors in Farm Credit System bonds that they have to take part of the loss. Now that might be something we would like to do in the future, but it doesn't solve the present problem.

Mr. CARPENTER. But I think you will send that signal, by not acting, a very clear message to that investor that he is a part of the problem and he cannot escape it. Agriculture has seemingly been removed, and carrying the load all alone. When the financial community understands that they will be a part of the obligation—and you can send them that message by pointing out you are not going to bail out the financial community and let the farm community die——

Mr. GUNDERSON. I think you understand the problems we face with basis points, with the interest rates, et cetera, in the Farm Credit System. We don't have the luxury of just standing up here and giving good political statements. We have got to deal with the reality of how we get some credit for next spring. I know and you know that we are going to have a major credit crisis next spring, and I don't want to come back and say, "Well, part of the reason we have got it is because we let the Farm Credit System go under."

Mr. WEAVER. The gentleman's time has expired.

The gentleman from Texas.

Mr. **Stenholm**. I was going to ask pretty much the same question. I think you have been very specific, Mr. Carpenter.

Let me ask you, Mr. Niese: You and Mr. Carpenter both have insinuated that this subcommittee do nothing in credit unless we do something in the area of farm income. I take it that assumes that what we passed out of the House is not adequate. Therefore, you are suggesting we do nothing to assist in the Farm Credit System unless we go back and revisit the farm program?

Mr. **Niese**. As was pointed out in the testimony that I gave a few minutes ago, there is some administrative action that may be considered to be taken that would be helpful, such as a moratorium, whether it be long term or short term, in relieving some of the pressure that is out there within rural America today and within that family farm unit. We believe in and support the family farm concept, but the Farm Credit System or any other agricultural lender out in rural America today looked at the balance sheet several years ago and made the decision to extend credit on an equity basis, but they are not operating that way any longer and haven't been for the last 2 to 4 years, simply because the cash-flow has not been there.

What I am saying is, to extend additional credit into the farm system without some plan—because it is a complex problem—to support farm——

Mr. **Stenholm**. No, no. Let me interrupt you right there. That's not my question. What I'm asking you is if you agree with Mr. Carpenter's testimony, and you inferred that you do, that we do nothing in the area of farm credit—because it is physically impossible for us to revisit that in this bill, what we're talking about is the farm credit necessity—Mr. Carpenter has very articulately stated we do nothing. Do you agree to that?

Mr. **Niese**. Without income support to the producer, support to the producer——

Mr. **Stenholm**. More than what we have done from this committee that passed the House?

Mr. **Niese**. That will enable the producer to positively cash-flow his operation, he is not going to be able to repay the interest and the principal back to the agricultural lender, whether it be the Farm Credit System or the commercial agricultural lender independent of the Farm Credit System.

Mr. **Stenholm**. So you basically agree we do nothing unless we do additional steps in the area of farm income?

Mr. **Niese**. I am suggesting to the chairman and to the subcommittee that it's necessary to look at both.

Mr. **Stenholm**. Mr. Delano, when you recommended to the conference on the budget support of Gramm-Rudman-Hollings because it was the only kid on the block, did you make any suggestions for change in that or did you indicate your association's absolute and total support for it as it passed the Senate?

Mr. **Delano**. Mr. Congressman, I don't know the detailed answer of that question because the decision was made to support it. I assume that it was made, that the principle involved there is what we were speaking to, now, which would mean the way that it came out of the Senate, the principle that was involved in it, to balance the budget in 1991.

Mr. STENHOLM. Then my question, if you are supporting the principle, why did you find it difficult to answer Mr. Glickman's question on the principle of support of the Farm Credit System?

Mr. DELANO. I don't quite get your point, sir.

Mr. STENHOLM. Well, Mr. Glickman was asking you regarding your—and you admitted that your statement was a little fuzzy because you don't know all the details as yet on what we're talking about, and that's a good reason why we are all kind of tippy-toeing around this situation, because we don't know all the details as yet. But my question is, apparently according to this Kansas newsletter you have thrown your support to the Gramm-Rudman-Hollings concept without really knowing, other than the principle of it, but when it comes to the farm credit, in testifying to this subcommittee with some help that we're asking all of you for, you are having difficulty with giving us those kinds of answers because you haven't had time to look at it yet. I am a little troubled by that, and maybe that's not what you have done. Maybe this is taken out of context.

Mr. DELANO. Yes. Well, of course I don't have all the answers, No. 1. I indicated in response to Congressman Glickman that we do have a committee, and I don't want to precede the committee, and we will have some recommendations relative to the whole farm credit situation at a later date but we don't have it right now. That's why we were so fuzzy. Now I have my own personal ideas, but I want them to come from the organization and be approved by the board.

Mr. STENHOLM. Well, I don't want to pursue it any further. I think you gather my point at this time. Apparently you have jumped—and there are a lot of us who agree, and I happen to be one who agrees with you on the constitutional amendment, but if we get that we've still got to have a mechanism to get there—but there are some real shortcomings in the pure Gramm-Rudman-Hollings that hopefully are going to be corrected. I hope that what you have said to your State associations and what you have said to the conference, is that you have agreed to the principle but that you have bothered to take a little bit of time and study the mechanics of that, particularly as it affects agriculture and some of the testimony that you have brought here today. I hope that you have done that.

Mr. WEAVER. The gentleman's time has expired.

The gentleman from Iowa.

Mr. EVANS of Iowa. I have no further questions, Mr. Chairman.

Mr. WEAVER. Thank you.

The chairman of the Agriculture Committee, the gentleman from Texas. Oh, excuse me.

Mr. THOMAS. I yield my time, Mr. Chairman. I have no questions.

Mr. WEAVER. The gentleman from Georgia yields his time.

The gentleman from Texas, the chairman of the committee.

The CHAIRMAN. Thank you very much, Mr. Chairman, and I want to thank the four witnesses for their contribution this afternoon. As all of us know, this is a very difficult area. It's an emotional area, but we know it's an area that needs to be addressed, and we are going to try as best we can to address the issue, and I thank you.

Mr. Delano, just one word, and I don't challenge your statement or the position of your organization. The only problem is, in your testimony or in your answer to Mr. Stenholm, all of us in principle support that we should balance the budget but the responsible organization that you represent—we had the administration here. We had a representative from the Department of Agriculture to testify or to visit with us, how they would implement the Gramm-Rudman, and he didn't know. He had no answers. It was all conjecture. We gave hypothetical questions and he had no answers, except that all of us agreed that it would be possibly very highly detrimental to agriculture at the worst possible time.

I don't know yet how I am going to vote but I say this as a friend, and respectfully, that because it has the name Gramm or because it is supported by the administration doesn't help us. To write letters, sometimes accusatory or sometimes in support of legislation, when the administration itself came and sat at that table and said, "We don't know how we would apply it, we don't know how we would enforce it," I say this only as a friend, for your information.

Thank you very much, Mr. Chairman.

Mr. WEAVER. I thank the chairman.

Gentlemen, thank you for your very helpful and beneficial testimony.

Mr. STENHOLM. Mr. Chairman.

Mr. WEAVER. The gentleman from Texas.

Mr. STENHOLM. I would like to ask——

Mr. WEAVER. With unanimous consent, the gentleman will have 1 minute to ask a question.

Mr. STENHOLM. I would hope we could have a little more than 1 minute.

Mr. WEAVER. Forgive me. If the gentleman wants a second round, the gentleman is recognized for 5 minutes.

Mr. STENHOLM. Thank you, Mr. Chairman.

I would like to ask each of you, since you do represent farmers, farmer borrowers and farmers, the question regarding some of the statements that have been insinuated before this subcommittee of the lack of confidence by farmers in the Farm Credit System—directors, management, top to bottom. I would like to have a brief comment from each of you regarding your confidence in or lack of confidence in the Farm Credit System—directors, management, problem areas—versus the suggestion that has been made to this subcommittee is, the increased regulatory powers that are going to be necessary if we are going to have an improved system.

Let's start with Mr. Niese.

Mr. NIESE. Producer confidence in the Farm Credit System is confused, in the producers that I have talked to personally, because of what they have read and because of what they hear. That confusion can be generated on both sides, if you will, by positive as well as negative statements. Some of the statements were referred to earlier this morning, such as salary increases in the Omaha District of 3 to 6 percent at a time when the Farm Credit System itself is under question.

But, by the same token, on the other side there is producer involvement in that Farm Credit System, and that adds credibility to the system. So in the long term it becomes very important that under any reorganization consideration of the Farm Credit System structure and management, that it should be done with caution, and most importantly, it should be done without the loss of producer involvement because that's where the confidence will start and that's what will maintain the confidence throughout the system as far as the producer is concerned.

Mr. **Stenholm**. Mr. Carpenter.

Mr. **Carpenter**. The farmer confidence in the Farm Credit System is very seriously eroded, based on two things: I think the system, in spite of its great contribution over a period of time, has been careless, and in the last several months or the last year or two has not been fully candid in speaking to the severity of the problem and in speaking in advocacy of the farmers' position with declining income. Now recognizing that, there is also an area of criticism because farmers are in despair and lashing out at whoever they are closest to, and the Farm Credit System receives a substantial amount of that criticism, which may not be as justified as the lack of candor and the careless behavior that they do deserve criticism for.

Mr. **Stenholm**. Mr. Morgan.

Mr. **Morgan**. Well, the Farm Credit System is a farmer-owned system. It is a cooperative system of credit and, like any other cooperative, it is only as good as the attention given to it. I recognize, and I think we all recognize that with this credit crunch, farm credit has gotten more attention in the last year or 18 months than it has gotten in the previous 30, from the standpoint of everyone concerned. Obviously the system needs some reorganization and restructuring but I think it is paramount that we keep the basic cooperative farm system intact, so they can work to provide their own credit system. I think, looking at the proposals that have been made by the Farm Credit System, we can do that.

Mr. **Delano**. Well, I think whenever you have stress in a system such as the Farm Credit System, it always affects the credibility, but I think money is a commodity. Most farmers know that money is a commodity. You buy it as cheap as you can. Just like you buy an automobile, you buy money, and I think they understand this. If they can get it cheaper somewhere else, they go somewhere else. As long as the Farm Credit System is competitive, farmers will stay with the system. If they can get credit elsewhere cheaper, they will leave.

Mr. **Stenholm**. I will pass on any further questions. Thank you very much.

Mr. **Weaver**. I thank the gentleman from Texas.

Does any other member wish additional time?

[No response.]

Mr. **Weaver**. If not, gentlemen, thank you very much for your very helpful testimony.

The Chair will call Mr. Norman Barker, president, National Milk Producers Federation; Mr. Irwin J. Elkin, president, Associated Milk Producers; Mr. Derryl McLaren, board member, National Corn Growers Association, Mr. John Ross, National Cattlemen's

Association; Mr. Lloyd Cline, vice president, National Cotton Council; and if we have room, and I believe we do, Mr. Jim Billington, National Association of Wheat Growers.

First on the list is Mr. Norman Barker. Would you proceed, please, Mr. Barker.

STATEMENT OF NORMAN H. BARKER, PRESIDENT, NATIONAL MILK PRODUCERS FEDERATION

Mr. **Barker**. Thank you, Mr. Chairman. I am Norman H. Barker, president of National Milk Producers Federation and a dairy farmer from Pratt, KS. I would like to commend you, Mr. Chairman, for holding these hearings on a critical issue, which is the financial future of the Farm Credit System. Likely most are familiar with the federation. Most of the Nation's milk supply is marketed through the cooperative associations represented by the federation.

I am here today because the availability of credit has always been critical to the agriculture industry, regardless of the commodity from which farmers earn their livelihood.

There are many sources from which producers secure credit, and in light of the tremendous economic instability throughout the varied agriculture finance system, comprehensive measures to address these problems will, in the final analysis, be necessary.

Thus, in the interest of providing members of the subcommittee with our views on the Farm Credit System and its current condition, I will focus my comments on the Farm Credit System. I am here to urge the subcommittee to move forward on legislation which would give direct assistance to the system, which would allow the system to maintain its independence with stronger FCA regulation, and I take this position for several reasons.

It seems to me that there are two central issues facing American farmers. One is farm income and profitability. The second is the availability of credit, and at an affordable rate. Of course, if there were adequate income there wouldn't be as much of a compelling need to discuss the credit issue. I think that has been pointed out. The 1985 farm bill, as approved by the House of Representatives, can help address the income side, but if the reality is that we have a credit crunch, then it must be addressed.

Since the system has been a primary source of credit and equity for producers, it is imperative that actions be taken to ensure that it can deliver credit to farmers at a competitive rate of interest, and that the producer-owners' equity be protected as best possible to avoid the further deterioration of their net worth.

It has been repeated several times here, but it is likely worth being said again, that the system was founded to provide credit to farmers and their cooperatives when no other institutions would assume the risk during the Depression. Given that historical mission and the fact that the system has carried out that mission, it is not surprising that in view of this financial crisis, just as its owner-patrons are facing individual financial crises, that we appear.

I think there is little dispute that the system has effectively carried out it mission for the past 50 years. The record also shows that this cooperatively owned system repaid the Federal Government's initial investment and has operated in a financially responsible manner over the past 50 years.

I think the troubles we are now experiencing in the system, and in agriculture as a whole, are the result of actions taken by the Government, starting with fence row to fence row agricultural policies of the late sixties and early seventies, and for several other reasons—the current level of the deficit, high interest rates, and a strong U.S. dollar—issues that handicap exporting to the markets that are left. While inflation is something no one wants to complain about when it is reduced, the other side perhaps—a deflated economy with depreciation of land values—may prove to be the last straw with our industry which so vitally depends upon land for its livelihood.

The magnitude of this crisis is so great that I do believe the Federal Government should come forth and assist the system, and in turn, agricultural producers. I firmly believe the Farm Credit System has been buffeted and bothered by conditions and circumstances beyond its control, and ought to have the opportunity to readjust to these dramatically different circumstances in a similar way that other industries have been provided Federal relief through various Federal actions.

We would like to urge the subcommittee to move forward and support legislation that would allow the system to remain solvent, independent, with stronger control. The Federal assistance could come in a combination or a variety of ways. We would suggest, among those, a direct infusion of capital from the Government with long-term, low- or no-interest loans; loan guarantees to ensure access to capital markets; and assurances that the debt obligations of the system would remain a quality investment.

In summary, the farm credit crisis is real, is an immediate problem, and it's an issue which cannot be put off. It must be addressed on the basis of maintaining stability through our entire domestic financial system and providing relief to the producers. As indicated earlier, we believe that the historical success of the system provides economic justification of the Government to provide a needed helping hand to alleviate the current crisis.

Mr. Chairman, I would like to commend you and the other members of the subcommittee for holding this hearing. We in agriculture are facing a difficult period in economic history. The linchpin of our surviving this crisis hinges on our ability to assure a continued source of adequate and affordable credit for our farm community.

Thank you for the opportunity.

[The prepared statement of Mr. Barker appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Barker, for your testimony.

Now Mr. Irvin Elkin appears next on the panel, president of the Associated Milk Producers of San Antonio. Irv, we are glad you are here, and you may proceed.

STATEMENT OF IRVIN J. ELKIN, PRESIDENT, ASSOCIATED MILK PRODUCERS, INC.

Mr. ELKIN. Thank you, Mr. Chairman, members of the subcommittee. My name is Irvin J. Elkin, a dairy farmer from Amery, WI. Along with my family, I milk about 40 Holstein cows and farm 200 acres of corn, alfalfa, and small grains.

I am president of Associated Milk Producers, Inc., the Nation's largest dairy farmer cooperative with over 31,000 members located in 20 States throughout the Midwest, South, and Southwest, who produce about 11 percent of the Nation's milk supply. I also have the honor to serve on the executive committee of the National Milk Producers Federation and as a member of the National Commission on Agricultural Trade and Export Policy.

We appreciate the opportunity to testify today. Recognizing that others have already covered the farm credit problem from virtually every conceivable perspective, which I have listened to with great interest, I am going to keep my comments very brief.

First and foremost, we want to emphasize that the current credit crisis is a symptom of the agricultural condition and certainly not the cause. The best and only truly effective way to alleviate the credit situation, long term, is through improving farm income.

In AMPI we have repeatedly maintained that improvement of farm income must be the No. 1 priority in constructing responsible programs for the 1985 farm bill and future national agricultural policy. America's farm families cannot be allowed to endure the kind of dismal returns that have unfortunately characterized recent years.

Adequate credit is an essential tool for today's progressive agriculture, and a healthy Farm Credit System is essential to the farm economy. It is evident that Federal help in some form is essential to meet current problems. The debate is not if but, more appropriately, how. Moving to the specifics, we would like to share the following thoughts.

One, Federal help for the Farm Credit System must come quickly to provide the necessary support before internal reserves are exhausted and the elements of the system are too weak to do their jobs.

Two, any assistance must emphasize helping farmers and not just the institutions.

Three, finally, the assistance must be fair and equitable and avoid aiding one group or type of farmers at the expense of another.

In the interest of time, I have kept my comments to a minimum. We do not mean to gloss over the seriousness of the problem or the urgency of taking action. We applaud Chairman Jones and the subcommittee for addressing this issue, and look forward to the development of a workable solution that will lead toward correction of the problem.

In closing, let us reiterate that the surest way to protect the Farm Credit System is the adoption of sound farm programs that will increase farm income. Farmers earning a fair return on their investment is the simplest and most viable answer to the farm credit crisis.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Elkin appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much. I'm sorry that I was doing something else when you did finish, Irv.

The next member on the panel is Mr. McLaren, Derryl McLaren, board member of the National Corn Growers Association of Washington. Mr. McLaren, thank you for being here. You may proceed.

STATEMENT OF DERRYL McLAREN ON BEHALF OF THE NATIONAL CORN GROWERS ASSOCIATION, NATIONAL ASSOCIATION OF WHEAT GROWERS, NATIONAL COTTON COUNCIL, NATIONAL CATTLEMEN'S ASSOCIATION, NATIONAL GRANGE, AND NATIONAL WOOL GROWERS ASSOCIATION

Mr. McLAREN. Thank you, Mr. Chairman. I want to emphasize at this time that I have been asked to give testimony for six farm organizations. This testimony reflects the united view of our organizations, and I would like to mention them at this time: National Corn Growers Association; National Association of Wheat Growers; National Cotton Council; National Cattlemen's Association; National Grange; and the National Wool Growers Association.

With me giving testimony today to my left is Jim Billington. He is a farmer from Oklahoma, representing the National Association of Wheat Growers. To my far right is Lloyd Cline. He is from Texas, representing the National Cotton Council. And to my immediate right is John Ross with the National Cattlemen's Association.

My name is Derryl McLaren, and I am a farmer from Farragut, IA, and I produce corn, soybeans, and hogs. I am also a Federal land bank stockholder in the Omaha farm credit district. I would like to hit the highlights of our testimony that we presented to you. As we go through you can follow along.

We have reviewed several economic analyses of the problem, including some of our own and some prepared by USDA. We find the information frightening. Recent economic studies that we have looked at indicate that up to $50 billion in agricultural credit may be unserviceable, given the present economic conditions in agriculture. What this means to our communities is loss of jobs and disruption of our rural communities, which is now very significant in many parts of our country, forcing a tremendous and tragic change on rural America. I believe what we are facing is somewhat of a land reform in reverse, contrary to what our Founding Fathers thought should be the general distribution of land ownership.

This debt at risk or bad debt, if you will, is not—contrary to popular opinion—confined to a certain segment. The credit problem extends to all sectors of lending in all areas of agricultural production. [See table 1.]

In our table 2, that we have presented in our prepared statement, you can see that the full-time family farmers and ranchers, that account for over 70 percent of agricultural production, are the hardest hit by the present financial stress. It's the heart and soul of agriculture and, contrary to popular opinion, what our analysis shows is that the typical farmer that is experiencing this stress has certain characteristics.

One, he is a high renter. The majority of the property that he has management over is rented property. He is young; he is below the age of 45. He has low off-farm income compared to the average of the farmers. Basically that reflects that his wife is working. He has a high cash flow operation and again, as I say, contrary to popular opinion, he was not necessarily an aggressive land buyer in the late seventies and early eighties. You could also typify him as being either a crop or a pork producer.

However, stress is reflected in all areas of the country. The problem exists for all sectors of agricultural production and lending. As a result, Congress cannot afford to focus on one sector to the exclusion of the others, nor can it focus on one region to the exclusion of others. Any kind of relief package must account for borrowers and for the different kinds of lenders throughout the country.

As agricultural organizations representing primarily producer-borrowers, we have been meeting to discuss the criteria which we think are appropriate to evaluate the various credit proposals that will be considered. We are also working out a credit relief package that the agricultural groups can accept and support. We urge you to also consider these criteria that we have worked out as you address the credit problem. The criteria are general but succinct, and I would like to go through them at this time.

One, any solution must focus on the agricultural producers who are under financial stress but who may survive with some assistance. One way of doing this is, we must make the portfolios of the lending institutions perform. If the portfolios and the loans are performing, we will forgo many of the losses, the numbers of which are staggering.

Two, high interest rates on agricultural loans must be reduced. Interest rates charged agricultural producers currently range as much as 6 points above rates paid by other industry. Referring to industry, we are an industry of individuals. Therefore, we pay several and varying rates of interest throughout the country.

Three, the farm bill is a necessary part of the solution, but is not a sufficient vehicle to resolve the whole problem.

Four, losses are occurring and will continue to occur, and must be shared by all participants in agricultural credit—taxpayers, borrowers, shareholders, lenders, stockholders, et cetera. No one segment can withstand the losses that must be taken. Some means of equitably spreading this loss across-the-broad economy must be considered.

We cannot afford the demise of a sector forced to assume too much loss. Forcing agribusiness firms out of business will not only compound the problem for local communities trying to adjust and absorb the financial losses, but we must recognize that through our analyses agribusiness firms reflect basically the same distribution of debt-to-asset ratios and financial stress as do farmers. Some attrition will be inevitable, but we need to avoid a domino effect which could easily occur in rural America.

Five, a viable means for delivering credit to agriculture is important and must be maintained. This may mean a restructuring of present agricultural credit institutions and relationships, but the result must accommodate the unique biological and cyclical nature of agriculture.

Six, mechanisms to prevent this financial crisis from occurring again. Preventing this from occurring again is a difficult task but we must try whatever steps possible to prevent it. We do not have an answer but it appears to us that oversight and regulation must be improved, both for commercial banks and for the Farm Credit System. The only real long-term prevention is, of course, for agriculture to be profitable.

In conclusion, we urge you to recognize that the problem is massive, it cannot be looked at as a problem of only the lending segment, and will require coordinated effort on a package of alternatives to be successful. It is, you might think of it as a multiheaded monster. It is going to require a delicate blend of tax law changes, farm income, creative financial instruments, debt extension, interest rate buy-downs, et cetera.

The Agriculture Committees have the opportunity to take a leadership role in developing the package. We urge and hope that you will take a broad view of the problem and the solutions that will be required. We look forward to working with you in this effort.

At this time I would make us all available for questioning.

[The prepared statement of Mr. McLaren appears at the conclusion of the hearing.]

Mr. **Jones** of Tennessee. Thank you very much, Mr. McLaren. We do appreciate your statement and, if you will wait, we'll give you an opportunity to be questioned later.

The next witness is Mr. John—I beg your pardon?

Mr. **Gunderson**. He spoke for all of them.

Mr. **Jones** of Tennessee. That's all?

Mr. **Gunderson**. His statement was on behalf of all of them.

Mr. **Jones** of Tennessee. I'm sorry.

Mr. **McLaren**. That statement was on behalf of all of us.

Mr. **Jones** of Tennessee. Very good. OK. Well, now, do you others have statements?

Mr. **Billington**. I would just like to make one slight, small statement. He spoke for all of us.

Mr. **Jones** of Tennessee. Mr. Billington.

Mr. **Billington**. Yes.

Mr. **Jones** of Tennessee. Mr. Billington, you represent the National Association of Wheat Growers, right?

STATEMENT OF JIM BILLINGTON, NATIONAL ASSOCIATION OF WHEAT GROWERS

Mr. **Billington**. Yes, we do, and it rained in Oklahoma so I got to come. I didn't think I was, so that's the reason my name wasn't on the list, but we are in a coalition and I think it's very fine that we are in agreement as to what needs to be done with this farm credit crisis. You know, we all have a right, we feel like, to a good credit system out in rural America because this is the only way that our assets can be transferred from one to the other, or for the young farmer to get started in agriculture or for the old people to get out.

We've got a real serious problem out there now, that the older farmers, my neighbors, who had they retired in 1980, sold out and moved to town, some of them did, those people are very well off.

They did everything right and they sold out at the right time. The people out there now that are 70 years old that would like to move to town cannot leave because there is no one, there are no entities or no person to buy those farms out in our country today, at any kind of a price that these people would accept. We can't get anyone in and we can't get anyone out.

My actions as a farmer now are not dependent upon me. They are dependent upon outside forces. I have been able to maintain my farm and my family operation satisfactorily up until this point in time. If I were to miss a wheat crop next spring or if cattle prices were to tumble in the springtime when I do a lot of my selling—which in a high-risk country like we live in—very, very easily could I be in serious financial trouble because the lenders cannot—I could not ask a bank to loan me money when he is looking at a declining asset value of my land.

If I can't cashflow my loan, the national bank examiner where I borrow the money is going to come in and say, "Well, Jim didn't pay his loan. He didn't get his operating money. That carryover money, we can't take that. We are going to put that over in a loss." That's the way they are operating right now, and that's the way they have to operate. They are going to say, "Jim, we can't refinance your operation." He can't refinance it on collateral any more because the national bank examiners are not considering collateral. They are looking at operating capital as operating capital. I can't go to the Federal land bank now and borrow money if I get in trouble because they're not going to loan it to me, so we've got some real serious problems out there.

We need to address this issue, and I know this subcommittee, Mr. Jones and your group here, have done some really outstanding work for us in the past. I feel very comfortable, in hearing what I have heard here today, that this will be resolved and that we are stepping in the right direction. Certainly we appreciate your interest and time in trying to help us. We would like to have farmers and stockholders of these Farm Credit Systems involved in the testimony in future program changes, not just the Farm Credit Administration people and personnel. I think we need local input, and we need these farmers out there to have a local credit source. I don't borrow money from them at the present time but I sure would like to have it out there available for my son-in-law, or maybe I might need it soon. I would like to have a local-controlled PCA out there or a Federal land bank to go talk to. I don't want to go to Wichita, KS, to borrow my money, and I'm not going to.

Mr. JONES OF Tennessee. Thank you very much, Mr. Billington. Although Mr. McLaren indicated that the others are represented by him, I just wonder if any of the rest of you would like to say something for yourself?

STATEMENT OF LLOYD CLINE, NATIONAL COTTON COUNCIL

Mr. CLINE. Mr. Chairman, my name is Lloyd Cline. I am cotton producer from Texas. I would just like to emphasize that I appreciate the work of the subcommittee, and I would like to emphasize that this is a program for producers, not—as has been referred to—a bailout for commercial lenders or the Farm Credit System. We want to, as producers, the members of this committee, we would like for you to remember that it's producers who are going to benefit from this, whatever program that you might evolve out of these committee meetings and out of the Congress.

We as producers want to have a part in it, and we will be continuing to work on some type of a program to present to you and to look at for the producer's benefit. I don't want us to ever forget that it's the producer out there on the farm, is the one that needs the help, and not the commercial lenders or the Farm Credit System. They need it too, but ultimately it's the producer that needs it greater than these institutions.

Mr. JONES OF Tennessee. Thank you very much, Mr. Cline—a very worthwhile statement, a very worthy statement. You will not find that there is a single person on this subcommittee that would be in disagreement with what you have said. That's who we have in mind, not the people on Wall Street, although we want the bonds to sell well. The investors should be protected in order for everybody to survive and thrive, but we realize that the grassroots of this country is dependent upon the financial condition of the Farm Credit Administration primarily, at least the majority of it is, because that's where most of the lending comes from.

The records speak for themselves, and that's what we have in mind here. When legislative history is made, if this subcommittee has something to do with it, I can assure you that that's what we will be trying to do, and we appreciate the input and the assistance that we get from groups just as you are. Your help is certainly needed, needed every day that we work and that we try to survive ourselves here.

Does any other member have something to say at this time? Mr. Ross.

STATEMENT OF JOHN ROSS, NATIONAL CATTLEMEN'S ASSOCIATION

Mr. ROSS. I am John Ross with the National Cattlemen's Association. I would just like to make one point, and that is that I think we probably have a stronger consensus amongst the agricultural organizations involved on this issue than I have seen on any issue in a long time. As Mr. McLaren pointed out in our testimony, it is not only a situation where the losses are going to have to be borne by more than just the borrowers of the system and the lenders, we will probably have to look at some way of spreading those losses wherever possible across the broader general economy.

The problem is broader and larger than the Farm Credit System, than the Farmers Home Administration. We recognize that the jurisdiction of the committee is over the Farm Credit System and over the Farmers Home Administration. We urge you to, with your actions with respect to farm credit and Farmers Home, demonstrate the leadership that we need to resolve this credit problem.

Mr. JONES of Tennessee. Thank you, Mr. Ross.

Now for our questioning by members of the subcommittee. Mr. Jeffords, you are recognized for 5 minutes.

Mr. JEFFORDS. We have had conflicting testimony in the last couple of days. Yesterday the farm credit people were here and indicated they were in trouble and needed some $5 to $6 billion to help them out. This morning the administration indicated that that probably was not necessary; that by 1988, based upon the same presumptions that we heard yesterday, things would get better and they really wouldn't need anything perhaps except some backup credit help with some redistribution of existing assets within the credit system. I wonder if you would let me know which one you agree with? Anybody want to try that one?

Mr. McLaren. The information that we have, we have been studying this issue for over a year now and looking into interest rate buy-downs. We have been gathering information on the Farm Credit System. We went into Frank Naylor's office in early March and told him it looked to us like there was a $500 million loss situation in the Omaha bank.

You must remember, when we are addressing this issue, we have only touched 25 percent of the loan volume so far in revealing a problem in the Farm Credit System. That's $18 billion of loans in the PCA system. We haven't even touched the Federal land bank yet, and here we are testifying before Congress on the magnitude of the problem. We have only scratched 25 percent of the possible loss volume that is being now reflected in the financial statements.

We must remember—and I would like to make a couple of points on some of the bailout plans or proposals being proposed by the Farm Credit System.

Mr. Jeffords. Please go ahead.

Mr. McLaren. Let there not be any question of what the Capital Corporation is. The Capital Corporation is a liquidation mechanism, pure and simple. Now who are we going to save? Are we going to save the farmers or are we going to save an institution? The farmers make the institution. The institution does not make the farmers. As we go along in this, we also know that the Farm Credit System must be salvaged in some form or another before it exhausts its total assets, its total capital base. We must act quickly on it, and we see the real need. We cannot do without a Farm Credit System, without implications of just a horrendous magnitude.

Mr. Billington. Could I help clarify that one point about the Federal land bank side of this issue. The loan that is made to a borrower in the Federal land bank association, the only time they have the financial statement of that member is when he makes a loan application. As long as he makes his payment annually, they are not aware of the credit status of that operation. The banker and the PCA even—and many times the reason these PCA's are in trouble in a lot of cases is because they made the loans to the Federal land bank borrowers to make a land payment, and the reason that Lloyd over here is interested in this is, some of the banks are involved in doing some of these things. They made operating loans to make land payments, and until a borrower defaults—as you heard in the testimony from the attorneys generals here, who I really appreciated, what they had to say, and they are correct in some of their assumptions—they do not know the position of their borrowers except that they are getting a payment.

So that's the reason we need some kind of local control. As long as you have it local, you know, these guys can check and see what's happening to their neighbors and friends, and they get the local scandal sheet. They know if they are in trouble somewhere else. They are alerted. But if we put all of these in Wichita, you know, and just have one little deal, we are going to be in trouble with this issue, so it needs to remain local. They don't know what kind of position those Federal land bank loans are in, and I can assure you they are more serious than they have indicated to us, in my opinion.

Incidentally, to indicate this, I went in—the National Association of Wheat Growers had a meeting with Mr. Wilkinson in March 1984. Now that's not very long ago, and I specifically asked him the question at that point in time, "What, Mr. Wilkinson, is your contingency plan for an infusion of Government capital in order to save this Farm Credit System?" And he became very angry. He said, "We don't need this. We can take care of all of our own problems. We do not have a problem. We've got plenty of resources to handle this." So I don't think they knew what the problem was until, you know, it's hitting home to them now.

Mr. **JEFFORDS**. I take by that comment that you would agree with their position now, even though your statement would indicate that they didn't know what their position was at the time you talked to them. In other words, they feel they are in deep trouble now but, as many of us found, they didn't seem to recognize any problems. Is that basically what you're saying?

Mr. **BILLINGTON**. They didn't recognize it, or Mr. Wilkinson didn't indicate that he recognized it in March 1984 when we met with him.

Mr. **McLAREN**. Basically there was no proper regulatory analysis or requirements on the system. Why on Earth did we have to call in GAO and Price-Waterhouse & Co. to give us an accounting of the system. They should have been able to give us an accounting themselves.

Mr. **JEFFORDS**. Thank you. My time has expired, Mr. Chairman.

Mr. **JONES** of Tennessee. Thank you very much, Mr. Jeffords.

Mr. Weaver.

Mr. **WEAVER**. Thank you, Mr. Chairman.

I appreciate the excellent testimony. It's very helpful, and to have it come from real farmers, like you, Mr. McLaren and Mr. Billington and others, it's very helpful. Mr. McLaren, the organizations you represent, did they all support the referendum language that we tried to get into the farm bill in the House?

Mr. **McLAREN**. This is kind of embarrassing. We have split up the responsibilities. We recognized the problems in the financial sector over a year ago, and we have split the responsibilities of our committee. I have been looking after the financial and the farm bill has been handled by others. We did not directly support it, as I recall.

Mr. **WEAVER**. Thank you.

Mr. Billington, what did Wheat Growers do on the referendum language?

Mr. **BILLINGTON**. The National Association of Wheat Growers had a lot of input, I think, into the bill passed by the House.

Mr. **Weaver**. No, I'm talking about the referendum, allowing farmers to control their own supply so they could get a better price, so they could pay back these loans.

Mr. **Billington**. Well, the National Association of Wheat Growers is made up of wheatgrowers and also cattlemen and also other people. When we reviewed that bit of legislation, we came to the conclusion that it was not the answer to our problem because of the major disruptions that would occur in export markets and the problems that we would see in the beef, cattle, and hog industry. So our group, it was their conclusion that they did not support the referendum.

Mr. **Weaver**. Well, this is not the time, and I understand that, to go into provisions of the farm bill, except that I am strongly of the opinion that we shouldn't infuse money into the credit system without at the same time making sure the farmer can become profitable again. All I see is that everybody talks about income for farmers but nobody does anything about it, and I just don't want to see good money thrown after bad until the farmer is on a basis where he can make a profit.

Thank you, Mr. Chairman.

Mr. **Jones** of Tennessee. Thank you very much, Mr. Weaver.

Mr. Gunderson.

Mr. **Gunderson**. Thank you, Mr. Chairman, and thank you to all of the panel members for your statements.

I want to ask a question of clarification the group that gave the combined testimony. You have a sentence near—I guess it's the last page of written testimony. You state, "We encourage efforts to maintain present structures and forgo abrupt structural changes until the financial viability of the agricultural credit sector is established."

You heard the administration suggest this morning that we have to establish a more independent regulatory arm in the Farm Credit Administration and that we have to provide the necessary legislative authority for the Farm Credit System to deal internally with some efforts to solve their own problems before they will consider any kind of line of credit or assistance. By this line in your testimony, do you mean to oppose what the administration said this morning or not? Could you just simply clarify for us what you mean by that?

Mr. **Ross**. Not at all, Mr. Gunderson. Our intent in this sentence is a statement about what has been perceived to be forced consolidations and forced mergers of production credit associations in some parts of the country. We say above here that it may mean a restructuring of present agricultural credit institutions and relationships. I think within that context providing for stronger regulatory authority on the part of the Farm Credit Administration may certainly be appropriate.

Mr. **Gunderson**. Fine. Go ahead, Mr. Billington.

Mr. **Billington**. I used to manage a production credit association until 1975, and I was an examiner before that time, and I am totally appalled at the condition that now occurs in this system, because in 1967 when we made examinations I think they were excellent, and we didn't have problems when I left the system. We had Federal oversight at that time because they still owed Federal money, and we had an auditing system. I don't know what has happened to that system but it was a good one, and it was very sound. If it had been followed and maintained, then I don't think that—I know we would have credit problems because of economic conditions. You can't foreclose that.

But I am in agreement with the administration, and even the request of the Farm Credit Administration, that they have much, much stronger regulatory authority because you can't let a financial organization, a system, audit itself. I mean, that just doesn't work. The banks found that out before 1900, and we have a dual banking system in this country now, and we have the Comptroller of the Currency. We need a similar organization for the Farm Credit System, that's a standoff link, and I think they are self-policing themselves, and I am very proud of them for that.

Mr. GUNDERSON. Good. I share your sentiments, so I happen to appreciate what you just said. Thank you all very much.

Mr. JONES of Tennessee. Thank you very much, Mr. Gunderson.

Mr. Stenholm, you are recognized for 5 minutes.

Mr. STENHOLM. I would like to hear the other members of the panel comment a little bit to what Mr. Billington just stated in regard to joint management, mergers, consolidations, and also probably another question, but let's start with Mr. Elkin. Comment a little bit on your feelings, either personally or association policy, if you have it, regarding what Mr. Billington just said.

The CHAIRMAN. Would the gentleman yield before he proceeds?

Mr. STENHOLM. Sure.

The CHAIRMAN. I do so, and I'm sorry to interrupt but I have a very important call I have to make at 3 o'clock, but I wanted to thank all the witnesses for your appearance here and your contribution, and assure you that it will be of invaluable help to us as we proceed along. For the rest of the witnesses that are here for the rest of the day, if I shouldn't be able to spend more time this afternoon, I thank all of you. Thank you.

Mr. STENHOLM. Before you answer, too, I want to make—my question is getting at, we have heard the lack of confidence by farmers, borrowers in the Farm Credit System. We have had lack of confidence in management. We have had insinuations. I'm not sure who we're talking about all the time. It's kind of vague in this, but also we have had strong testimony saying we need more local control of these associations. We have also had strong testimony now that we need increased regulation of those locally controlled boards, and that's what I would like to hear you comment to.

Mr. ELKIN. Well, we of course as an organization do business with the bank of co-ops. It happens to be the Texas district, and as this started to unfold there were concerns on our part because it just happened that district had been doing quite well. I mean, it had been a little more conservative, maybe, and then we find out that some of the others may have been a little more liberal, and then we find out that there is a shared responsibility coming up here. It certainly seems to me that—and I'm not against that, you know, it gives you a larger umbrella to deal with—but it seems like with this shared responsibility should come some shared obligations also.

So I think, although I don't see the problem with the local control, I certainly, as this is developing and discussed, see a problem with the more central obligation of some audits so each and everyone knows what is going on. In other words, I don't see how—I can see the problems and why they have developed, and it also is becoming apparent from the gentleman down here that when the Government still had money, direct funding in here, they required that, and rightly so. Somewhere, evidently when the system was cut loose from that—and by the same token, now that we are all here concerned that there needs to be maybe some further lending from the Government, some way, that with this money will also come provisos and "how to's" and that sort thing, again. You know, you've got to accept that.

But this has all been hastened, there is no question about it—by the essentially—collapse of the agricultural community which has highlighted it and brought it to everybody's attention. But I think I certainly agree with what my Congressman mentioned earlier: Although we look and say that we need some long-term cash back in agriculture or you can't service any debt, no matter what the interest, and that sort of thing, as we develop back to that that we are going to have to look at some tighter controls.

But on the immediate, we need the Farm Credit System in agriculture. There is no question in my mind, because I think it was very aptly articulated by my Congressman, saying, "You know, if you throw us to the wolves at this time, agriculture, we are a bad, bad risk." I know what I would do if I was a moneylender. You know, it would be tough to get money out there, and an awful lot of people would not qualify, you know, if the Farm Credit System went under. The bankers are not going to pick them up. So I think we are hearing some of the same things, that there needs to be some tightening of the system, but the system is awfully important.

Mr. STENHOLM. Lloyd, before you comment, I would be remiss if I didn't welcome my friend and neighbor to the West back home to the subcommittee today.

Mr. CLINE. Thank you, Congressman. Let me just add one thing, maybe a little different view here. My feeling is that this Farm Credit System ought to be controlled locally as much as possible. I think you ought to continue to have your separate organizations, and PCA's and Federal land banks and the bank cooperative group. I think as much as possible it should be under local control. I think you ought to start with, for instance, a State and then come down to your districts and then your different organizations in each district—PCA's, Federal land banks, and so forth. I think it ought to be an umbrella-type regulatory control authority similar to the banking system and it would be, in effect, very similar to a local bank. I think it would continue to function very favorably under those conditions. I opposed centralization per se in the Federal Farm Credit System.

I might just mention also, we talk a lot about the Farm Credit System, commercial lenders, insurance companies, trade credit sources have major problems also, and any legislation or any package-type deal surely needs to take everyone in consideration, not just the Farm Credit System.

Mr. Ross. The people that I represent, the Cattlemen, would like to see the system retain local control. Where it makes sense for a merger between local associations, and where the local associations essentially initiate that idea, there is strong support for merger and consolidation, but there is not support at all for merger or consolidation that is imposed or even has the appearance of being imposed.

Mr. McLaren. The Farm Credit System, with its farmer-borrower-stockholder relationship, is basically a passive system of ownership. I see those ownership rights being relegated to the professional money managers, or whatever you want to call them, in the system. We must retain the local ownership control of this organization.

Mr. Billington. Mr. Stenholm, being familiar with the system, there are some weaknesses as it is now structured. The 1971 Farm Credit Act, as passed, gave the authority for the approval of policies to manage and operate all these local associations to the Federal credit banks in the districts, and they had to be further approved by the FCA. If you let some central organization write the policies or approve the policies, they in a sense are going to write the policies, so they have moved to centralization, although the terminology used to pass that law—and I think they did a beautiful job passing it, it was a work of art the way it was handled—but it took local control totally out of the hands of the local production credit associations and put it in the districts and the FCA.

Therein, I think, is where the problems are. There are the local PCA's. I don't know why the Federal credit banks can't go out and find one of them that is well managed and well run. You have many of them in Texas. We have many of them in Oklahoma. They are well run, they are well managed, they've got good capital. They are financing the buyers in the district. They've got a reasonable interest rate. Those people, aren't they smart enough to go back and look and see who the successful guys are, and try to get them up into management or something and come to some answer? That's not the way they're doing it. They're coming from the top down. It needs to come from the bottom up. That's the way the system is going to work.

Mr. Stenholm. Mr. Barker, do you have any comments?

Mr. Barker. No, not unless there are specific questions, Congressman Stenholm.

Mr. Jones of Tennessee. Thank you, Charlie.

Mr. Evans, I believe you indicated——

Mr. Evans of Iowa. I have no questions.

Mr. Jones of Tennessee. Well, I'm not going to have any because we've got a vote, and I think we've held this group long enough, but let me say one thing, gentlemen, before you leave, and this applies to everybody who is here. We have all been talking about the Farm Credit System and the Federal financial aid that it needs. Let me point out to you that when the Congress strives to do something about this, some equal cuts are going to have to be made elsewhere, it looks like today. I need to know and the other members of this subcommittee need to know, where are we going to make those cuts? We have been all over the board already.

This is one committee, the Agriculture Committee, that is within the Federal budget. We didn't bring a bill to the floor of the House until we became that way, so we've got a big old problem facing us out there, and we need your help, too—not only your help but most likely your prayers as well.

Thank you very much. We will let you go, and I would like to ask the next panel to get in place while we are gone to vote. There's a possibility we may have two votes while we're gone.

[Recess taken.]

Mr. JONES of Tennessee. The subcommittee will resume its sitting.

I see that three of the witnesses are in place, and if Mr. Wellstone does show, we'll recognize him. Dr. Casper, I believe that you are first on the panel here, so we will recognize you, the director of the Crisis in Agriculture Project, Carleton College, Northfield, MN. We are pleased that you are here and you may proceed.

STATEMENT OF BARRY M. CASPER, DIRECTOR, CRISIS IN AGRICULTURE PROJECT, CARLETON COLLEGE

Mr. CASPER. Thank you, Mr. Chairman, members of the subcommittee. With your permission I would like to submit a statement for the record and then focus on a few key points in my remarks today. These points are illustrated on some charts which I would also like to submit.

Mr. JONES of Tennessee. Without objection, your prepared statement and the charts will be made a part of the record.

Mr. CASPER. Thank you.

First, I want to express some apprehension about giving the Farm Credit System and other lenders much money and much discretion to finance one or more loan warehouses as I heard proposed yesterday. In particular, I fear that this approach would result in giving billions of dollars to save one of the two groups in trouble—the lenders—while in the process creating conditions whereby the other group in trouble—family farmers—would lose their farms.

Every loan warehouse plan has a crucial decision point which is shown in the first chart. I think you have copies of this so you can see it. I realize that my Xerox machine wasn't up to the task here. At that decision point the financial condition of a farmer in trouble is subjected to a test. If the farmer's loan were restructured in a certain way—and that way varies, depending on the proposal—would he be able to cash-flow? If the answer is yes, the loan is restructured. If the answer is no, the farmer is foreclosed.

For example, using the latest USDA figures we looked at a warehouse that would actually deal rather liberally, in comparison to some of the plans we have seen proposed. It would write down the principal by 30 percent and charge a 10-percent interest to the farmer. If you apply that test to the midsized commercial farmers—shown on the next chart—if you take the midsized commercial farmers, those with cash sales between $40,000 and $100,000, there are about 102,000 of those who have debt-to-asset ratios of greater than 40 percent. Then if you apply that test—30 percent principal writedown, 10 percent interest rate—to those 102,000 farmers, you find that a loan warehouse which had that kind of a test would actually only pass, allow debt restructuring, to 40,000 of those farmers and it would say no, foreclose, on 62,000 of them. That's about as liberal a test as I have seen proposed, and it is very similar to Senator Boschwitz' plan.

Could I see the next chart, please? Well, it's not difficult to understand why this is when you take a look at the numbers in the USDA Bulletin No. 495, the financial characteristics of U.S. farms in January 1985. What those figures show is that half the farmers in trouble, those midsized family farmers, have no cash whatsoever left over for loan payments or rent after they pay their farm operating expenses and family living expenses. That is, they can't pay anything on their debt and so, no matter what the test would be, for about half the family farmers in that category there is no way that a loan warehouse would do anything to them but foreclose on them, so it's not a way of helping the family farmer in trouble.

If you will pass to the next figure, please, I have summarized what it seems to me would be the results of buying into the kind of plan that you heard suggested yesterday. For sure, the lenders would be rescued, but the decisionmaking would be far removed from the community, out to Wichita or someplace. There would be many farm foreclosures, given the present financial circumstances of farmers, particularly the commodity prices, and there would end up being a massive transfer of farmland. Those farmers who got foreclosed by and large would not be able to even rent their land, and eventually that land is not going to pass back to them, it seems to us. It is going to end up in the hands of large farmers and absentee tenant farm landlords.

The second part of my testimony, I would like to suggest a way of thinking about alternative emergency credit proposals and recommend to you a different kind of approach, what we call the fair credit plan, which would involve a comparable outlay of taxpayers' money to what the proposal that you heard about yesterday, but it would keep both lenders and farmers in business. It well satisfies the principles Governor Branstad presented here this morning. I guess I have been a little disappointed, in hearing the testimony, not to hear an alternative plan which really does try to address the question—"How are we going to keep the farmers on the land?"—and that's what I want to discuss.

The next chart shows what I think is a useful way of thinking about the farm credit crisis from the viewpoint of both the farmer and his lender. It shows that a typical farmer in trouble has a debt—"D" on that chart—which is considerably larger than the debt—"Do" on the chart— which the farmer can cash-flow, so the farmer is threatened with forced liquidation or foreclosure. At the same time, if the lender looks at the situation where he is not getting the full loan payment, the alternative of foreclosure doesn't look very good to him, either, because the lender's anticipated return on foreclosure is also very much less than the debt "D". Of course, you knew that but I just want to use this kind of a chart to illustrate how you might think about alternative credit plans.

Would you turn to the next chart, please? All the credit proposals, the emergency credit plans that we have seen discussed here and elsewhere in the Congress recently, all have one common feature, which is that the lenders will write down the debt to some extent. On that chart I indicate that as a write-down from debt D to debt D prime, so that would be the lender loss, but that loss would now be acceptable. It wouldn't be anywhere near as big as the anticipated loss on foreclosure that the farmer now anticipates, and so the lender would come out OK with his losses reduced to an acceptable level. But the proposals possible with that kind of a beginning—the lender taking some loss—what happens after that depends very much on, varies very differently, very, very much, depending on the proposal.

Now if you could turn to the next chart, I want to just suggest a different way of looking at what is possible with roughly the same expenditure of money as what was indicated yesterday. What we are suggesting in the fair credit plan which would be administered by the States, with local mediation boards, the lending institutions would write-down the farmer's debt to some level as shown in that chart, like D prime, and then the Government would pay enough to further reduce the debt to a level at which the farmer could afford to make payments.

The lender would lose some money in writing down the loan, but not nearly as much as the loss he would take if he foreclosed under the present circumstances. In this sense, the outcome for the lenders would be very much the same as under the lenders' proposals, but for the farmer in trouble the outcome would be much more just. The farmer would end up with a manageable loan payment and he would stay in business. Of course, the farmer would now owe the Government the amount the Government paid the lender.

Farmers not in trouble would benefit as well. By preventing many farm foreclosures, this plan would stabilize land and equipment markets, stemming the slide of prices that is reducing the assets of all farmers.

For the public, the benefits would include saving agricultural lenders from financial disaster and keeping on the land the experience and expertise of the family farmer. This, in turn, would benefit rural communities whose viability is linked to the survival of both lenders and family farms. Government costs would mainly come from deferring the farmers' repayment of the money the Government repays the lender.

I will take 1 more minute.

The rate at which a farmer would repay the Government would depend on the rate at which the farmer's cash-flow situation improved, which, in turn, would depend on the rate at which the farm commodity prices increased. In this way, the Government would acquire a direct and highly visible stake in the profitability of American agriculture.

An alternative mode of repayment available to those farms that got in trouble by expanding when land prices were nearing their peak, would be to turn over the expansion acres to a Government-administered beginning farmer program. In contrast to the lenders' plan—the loan warehouse—much less farmland would be transferred and what land the Government did acquire would be directed to beginning farmers at an affordable price.

In conclusion, this must be understood as a critical moment in the history of U.S. agriculture and rural America. In the coming months our agricultural structure and our rural culture could be precipitously and irrevocably altered, to the detriment of our entire society.

A key issue as Congress addresses alternative policies is public accountability. It would be a grave mistake to transfer Government funds to the lenders in trouble and tell them to use their best judgment in choosing between foreclosure and family farms. It is in the public interest to make sure the public funds we invest will be used to save both agricultural lenders and family farmers, and thus rural America, from financial ruin.

Thank you.

[The prepared statement of Mr. Casper appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Dr. Casper, for your statement on your illustrated charts, and I assure you the subcommittee will take a good look at your statement and the charts.

Mr. Wellstone, you will have to identify yourself because I do not have it on the witness sheet here, since you are evidently taking someone else's place, if you will do so, please, sir.

STATEMENT OF PAUL WELLSTONE ON BEHALF OF DANIEL LEVITAS, PRAIRIEFIRE RURAL ACTION AND IOWA FARM UNITY COALITION

Mr. WELLSTONE. Right. Mr. Chairman and members of the subcommittee, my name is Paul Wellstone and I am from Northfield, MN. I am here today representing Prairiefire Rural Action and the Iowa Farm Labor Unity Coalition. I just received notice a few moments ago that I would be asked to represent Prairiefire, and while that puts me a little bit on the spot, not having really prepared testimony, in another sense and in a very real sense, and I think in a very profound sense it is easy for me to represent Prairiefire.

Iowa Prairiefire and a good many other farmers and farm organizations throughout the State said all along that the farm crisis would become a lenders' crisis. We are not at all surprised at that. We are battling for the economic survival of our farms, and we are battling for the economic survival of our rural communities. I think as we talk about price and as we talk today here at this hearing about credit, it's very important to recognize—and I know the members of the subcommittee do recognize this—that we are confronted with the fierce urgency of now, that tomorrow is today, and that for many, many, many farmers and lenders, the long run is the short run.

I make this point because I think we have to think about this crisis, this moment in American agriculture, from both a long run and a short run point of view. Prairiefire in Iowa has been here at the Congress and has testified for the Farm Policy Reform Act. We believe, as many people on the subcommittee believe, that price is absolutely critical and key if we are to genuinely respond to the farm crisis, genuinely respond to people, to our communities. But we also know that this year alone many farmers, all too many farmers, will be thrown off their land unless we put into effect a decent debt writedown program which benefits not just the lenders—be they Farm Credit System or the bankers—but the lenders and the farmers and our rural communities.

I just would like to echo what Professor Casper said. We do not support a proposal which benefits the lenders, sets up perhaps some kind of quasi-private corporation which might only enable lenders—the Farm Credit System in this particular example—to be able to buy up the land, to be able to sell the land to this corporation, which will simply cause a rash of foreclosures. That's something we do not find acceptable.

What we do think is an important role for the Government to play, an important piece of legislation that could come out of this subcommittee, is a debt write-down program where the lenders write some of it down, the Federal Government writes some of it down to the point where people can cash-flow, and then it is paid back at the point at which people can pay it back, which will be dependent upon price. So what we see is, a very strong linkage between the opportunity that your subcommittee has to put into effect, a really adequate and fair and equitable debt restructuring program, which will be tied to price. It's not one or the other. They are really quite interrelated.

Let me conclude this way, because I want to keep this testimony brief and short and I would be pleased to take questions if you have any. I am pleased that those of you who have been able to stay are here. I know it has been a long day and I know that you have more testimony to hear, but the reason that I am so pleased is, I think that what a lot of us have to say who are working in the communities is important.

What we have to say today is that in this dark and somber moment in a very proud history of American agriculture, we look to you for leadership, and we believe that in this moment of the financial crisis for farmers and lenders you can lay forth a set of proposals or a proposal which will be an adequate debt restructuring program, something quite different than what the Farm Credit System offered, something quite similar to what Professor Casper offered, which really can be of utmost importance in dealing with the short run and can also begin to leverage us toward a better price.

Thank you.

Mr. Jones of Tennessee. Thank you very much, Mr. Wellstone. We appreciate your statement, and we will take another look at it as the committee gets ready to present some legislation.

Our next witness is Mr. Richard Dailey, Family Farm Organizing Resource Center, St. Paul. Mr. Dailey, welcome.

STATEMENT OF RICHARD DAILEY, FAMILY FARM ORGANIZING RESOURCE CENTER

Mr. Dailey. Thank you, Mr. Chairman. Mr. Chairman, I am here on behalf of about three organizations, and the Family Farm Organizing Resource Center out of St. Paul, MN, is one of those organizations. My main roots lie in central Ohio. I am a member of the Family Farm Movement, and I am also a stockholder in the Farm Credit Accountability Project which we took to study the Farm Credit System and the abuses of power within that system. I have got a prepared statement but I would like to have that statement put in the record, if I may, and I would like to just make a few comments to the subcommittee.

Mr. JONES of Tennessee. Without objection, your statement will become a part of the record and you may analyze your statement however you like.

Mr. DAILEY. Thank you, Mr. Chairman. I will say one thing about this subcommittee. You guys have really received a full load of hay in the last 2 days.

Mr. JONES of Tennessee. Mr. Dailey, if you would yield just a minute, this is not the first load of hay we have handled, either. Sometimes it's big, round bales. [Laughter.]

Mr. DAILEY. It sure is, and it gets heavy at times, too.

No farmer has come up here and talked about this Farm Credit System we are talking about bailing out, and I guess I want to do that. Maybe I feel like I've been at their wrath for the last 5 years there in central Ohio. I hear the Governor of Iowa talk here this morning like maybe Iowa is kind of at the bottom of the barrel. Well, I think we were at the bottom of the barrel in about 1980 in Ohio. Many changes have happened in the Farm Credit System when you're looking at the Louisville District.

I hear the Farm Credit System people talk about their 92,000 loans in that system right now that are in bad shape. I don't care how you look at it, when you talk about bailing out that system or not bailing out that system, those 92,000 farmers have got the same problems before and after as they have right now.

Over 3 years ago, myself and 8, 9, 10 other farmers from Ohio sat down and we talked with Governor Wilkinson, and we told him what he had coming ahead of him. Mr. Wilkinson's response to us was about like it was to another group of farmers here. He said he had a handle on the problem and he was going to take care of it, and I think he has taken care of it to about the best of his ability, and I don't think that is very good.

One of the biggest things I have heard all through this subcommittee is about the farmer ownership of that system. I would like to say it nicer, but I am just sick and tired of it, because when you own something, you control it. You have some authority; you have some rule over it or something. If you look at the Farm Credit Act, it says that the farmers will have control and operate the Farm Credit System. The Farm Credit System uses the terminology that it will be "owned and directed"—and I hear them repeat that many times—"owned and directed by farmers."

All during these hearings we have heard a lot of figures, gentlemen. Boy, they've got a lot of zeroes. I don't even know if I can count that many zeroes, but they are talking about billions. As a farmer, and as somebody that has looked at this Farm Credit System for the last 5 years very closely, besides farming 1,000 acres—and I am a producing farmer that's out there every day—we talk about a $1.6 billion reserve, we talk about a $5.5 billion surplus, and then we talk about 5.3 billion dollars' worth of stock. I would like to entertain to this subcommittee that the 1.6 billion dollars' worth of reserve and the 5.5 billion dollars' worth of surplus should be the ownership of the stockholders who own 5.3 billion worth of stock, but I am here to tell you it doesn't belong to them, so if it doesn't belong to the stockholders, who does it belong to?

I recognize that banking has to have reserves. I am a little confused if this system really needs to be bailed out now. I don't agree with the administration on very many issues, but when Dr. George Bolling, who prepared the "Farm Credit System Abuse of Power," at which time he filed a $6 billion suit asking for the recovery of $6 billion of stockholder equity to be given back to stockholders—now that could have been given back in the form of stock, so we're not taking the cash out of the system—George's analogy was that this Farm Credit System had stolen this kind of money from us.

You know, the nicest words I can say about the Farm Credit System, the nicest thing I can say about them, they are liars, cheats, and thieves. I realize that is not very polite, and maybe it has no order in this room, but as a farm producer I have seen farm families kicked off their farms about as much as I want to. I have seen about as much pain out there on the farm that I want, in my own personal family, in my own personal situation, and hundreds of other farmers in Ohio.

You know, the last panel of farmers that was up here, they talked about local control of the Farm Credit System. The Farm Credit System, as I see it, is about like the consolidation of school districts which we saw across this country about 20 years ago. A lot of people opposed it but in my area of Ohio, and I assume the rest of the country, those consolidations took place. I am not sure even today any of us still agree with that.

I see the same thing happening in the Farm Credit System. They are talking about having local control of the Farm Credit System. They live in a different part of the country than we do, because they have already taken all local control away from Ohio, Indiana, Tennessee, and Kentucky. We have already been merged. But to show you how much confusion that is in that system, a couple of years ago they started merging two little districts. Before they got the two little districts merged and members voted on it and so forth, they were going to merge us into 28 districts in the Louisville district. Before that took place, they ended up, now we are going to go into one association. As far as I know, members haven't voted on anything. I contend that it is not a farmer-owned organization. Only by legislation is it, but in reality it is not.

When I called the Farm Credit System liars, the past 5 years they have given testimony to many people, published many articles, and up to 3 months ago, guys, we didn't have a problem in this country. We didn't have a problem anyplace in this country. All at once we've got a catastrophe where they need a bailout. I saw them pull a tactic the other day where they said they had 18 days cash reserve. Gentlemen, I don't know—maybe somebody here knows—in that system, and understanding that, maybe an 18-day reserve of assets is as much as they have ever had, and I don't think they explained that. I missed Mr. Wilkinson's presentation, so there are things that he might have covered that I missed.

In 1981 to 1984, the Farm Credit System had an increase in salaries of 72 percent. I find that very difficult to understand, when I know during that very time there was a big cutback in personnel.

The Federal land bank has increased its reserves for losses by 42 percent. You know, we saw those charts in here that the farm credit System brought in here, and all I can tell you is, they just keep moving those lines around. We currently had a $500 million loss in the Farm Credit System. I contend they just moved that line around. One of the representatives here mentioned something about the value of his house. About the only thing that happened there was, the value of the house changed.

Well, I see we're getting down to the end of my time here, and I am going to now conclude my statement. Thank you very much for allowing me to be here.

[The prepared statement of Mr. Dailey, appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Dailey. We appreciate the statement, and I assure you the subcommittee will take a good look at the entire statement.

The next witness and the final witness on this panel is Mr. Tom Saunders, Wisconsin Farm Unity Alliance, Glenwood City, WI. Mr. Saunders, welcome, and you may proceed.

STATEMENT OF TOM SAUNDERS, BOARD MEMBER, WISCONSIN FARM UNITY ALLIANCE AND THE NORTH AMERICAN FARM ALLIANCE

Mr. SAUNDERS. Thank you.

My wife and I and our four children are dairy farmers in northwest Wisconsin. I am a board member of the Wisconsin Farm Unity Alliance and the North American Farm Alliance. I want to thank the chairman and the members of the subcommittee for the opportunity to share with you the concerns we in the Farm Alliance have for the future of family farming in the United States. I have a prepared statement which I would like to have entered into the record.

Mr. JONES of Tennessee. Without objection, it will be made a part of the record.

Mr. SAUNDERS. Thank you.

There can be no bailout of the Farm Credit System without a price for farmers. The plan put forward by the Farm Credit System here yesterday may bail out the system, but it will not bail out the farmers. There is very little difference between their early proposal for an Agriculture Conservation Corporation [ACC] which was widely rejected as only a system bailout. Without higher prices to increase farm income, the bad loan bought up by the loan warehouse would stay bad and would end up in an ACC-type holding corporation. Warehousing is a plan for foreclosure. It is a plan to expedite the transfer of land from farmers to investors.

As an organization which does advocacy work for farmers, we are used to the system negotiating in bad faith. I must clarify this by saying that when I refer to the Farm Credit System, I mean the 100 men the gentlemen from Grassroots in Texas spoke of in their testimony yesterday, not the local managers and the borrower board members.

With the exception of certain well-managed branch offices, the system as a whole encouraged overborrowing throughout the seventies. Now in the eighties, when the economic situation has gone bad, they have turned away from their share of the responsibility for the crisis and proposed to save their good loans or their bonds at the expense of the farmers.

This behavior is consistent with the vision for agriculture laid out in the Farm Credit System's project 1995 report, a study prepared by some of the 100 men. In this vision, there is plenty of talk about assets, capital, centralization, and resources, and nothing about protecting farm families, rural communities, and ensuring democracy. I quote from the Farm Credit System's Project 1995 final report: "The system can no longer afford the luxury of a slow, methodical decisionmaking process that involves grassroots input to the extent utilized in the past." Again, "We should redefine the system's cooperative business philosophy and principles to keep pace with the value systems of its owners and customers."

This is clearly not what the Farm Credit System was created for. The Farm Credit System was created to provide credit for farm families that are members and potential members, not as a centralized bank which moves to cut loose its distressed members to protect itself and its bonds.

The only way to change this vision is to encourage participation of people in its development. Democracy cannot be sacrificed for speed. The system must see its role as serving the whole rural community, not just its current owners and customers. This is the only way to protect the welfare of all of the borrowers.

Here is our position on any bailout for the Farm Credit System: First, implement a temporary moratorium on all foreclosures until farm prices are raised to levels that can sustain the farm debt.

Second, target bailout funds to provide interest rate reductions to all members, and eliminate the present policy of charging higher interest rates to distressed borrowers. Third, require an annual, independent outside audit of the Farm Credit System.

Fourth, establish a borrower's bill of rights that sets a clear policy of forbearance and establishes a minimum family living allowance; allows members access to bylaws, files, and membership lists; and sets a clear and impartial appeals process.

Fifth, halt all mergers of local associations and moves to further centralize the Farm Credit System.

Sixth, expand and fully implement the Young, Beginning, and Small Farmer Program established by Congress in the 1971 Farm Credit Act, and include former borrowers.

I would like to go back to my original point: There can be no bailout of the Farm Credit System without a price for farmers. As the independent bankers testified here yesterday, you cannot solve this crisis in the Farm Credit System without an increase in farm income.

I would like to try and anticipate my Congressman from Wisconsin's question about this point, which has been brought up time and time again, that this is not the committee to deal with price.

It is very frustrating for those of us in the farm movement, who have struggled without adequate resources to make the members of the Agriculture Committee and the whole House see the crisis of agriculture in human terms, to look at the loss of farm families and the destruction of rural communities that is taking place. We spent all summer arguing about what farm programs would do to exports, and almost no time discussing their effect on people and rural communities.

I might add that in December 1984, when we met with the officials of the Credit District Bank in St. Paul, and they showed us the charts of the legislative council and the grassroots input, and all of the ways that they were going to begin working with Congress and with us to raise farm prices, I have no knowledge that they participated in the farm bill debate. Maybe some of you talked to them. What I do know is that in the last month they have moved some 10 to 20 people out here permanently to lobby on the bailout.

Now, when the crisis is in full view, we are told that farm prices cannot be part of the discussion.

The way my neighbor, Alfred Hokenson talks about this problem—I want to tell you a little story—is like this: "They told us to dig a ditch but they locked all the shovels in the tool shed. Now we are all out here struggling to get it done with old buckets, sticks, and our bare hands, and arguing about the best way to do it, and getting nowhere. Somebody has got to go to the tool shed and get out the shovels because the people are ready to grab hold of the handles."

This committee, the Subcommittee on Conservation, Credit, and Rural Development, as well as any committee in the Congress, must deal with these issues from the perspective of the whole country and not just from the perspective of the 100 men and their bonds.

Thank you.

[The prepared statement of Mr. Saunders appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Saunders, for your statement. We do appreciate very much each of you gentlemen being here.

Now I yield to Mr. Gunderson for any questions that he might have.

Mr. GUNDERSON. Thank you, Mr. Chairman, and to all of the panelists for your presentations. I share much of your frustration, as I guess everybody in this room and I know everybody on the Agriculture Committee has expressed many times this year our frustrations at the challenges that we face and the lack of solutions to try to deal with them.

We again get back to one of our major frustrations on this subcommittee, which is our jurisdiction, which is what we have authority over in this Congress and what we do not. I guess my concern is that I think people such as yourselves could go home and be very critical of this subcommittee. We don't do everything you would like us to do, when the reality is that we don't have the power, the authority, to do much of what you would like us to do.

Mr. Casper's plan, which has been endorsed by many of you in terms of dealing with a new way of taking the same amount of money and trying to prevent foreclosures and have an interest buydown, et cetera, for farmers, you know, we can look at something like that in the Farm Credit System but we can't look at that in commercial banks. We don't have any authority, in anything we pass out of this subcommittee, to deal with this kind of money in the commercial banks. All we can do is deal with the Farm Credit System.

I guess if I would like to leave a challenge with any of you and all of you combined, we will be moving in the near future, I would expect—only the chairman can answer that—but I would expect we would be moving in the near future with some type of legislative recommendation. Obviously something will be up on the floor. What you need to do is take a good look at the Farm Credit System, analyze from that perspective the number of borrowers which you believe are in trouble, and try to determine exactly what kind of Federal funds would be necessary to incorporate this process within the Farm Credit System, because that is really all this bill is going to deal with. It is not going to deal with the Farmers Home Administration. We'll get into that next spring. The commercial sector, the Banking Committee may or may not get into. If you could, you know, try to adapt some of the concerns you have and make some suggestions directly to the Farm Credit System, I for one would be interested in reviewing those at a later date.

I guess I don't have a question——

Mr. CASPER. Mr. Gunderson, I think that calculations that we have done and those that Neil Harle has done at Iowa State suggest what I said in the testimony, that the figures that were presented yesterday about how much it would cost essentially to liquidate most of the loans, the troubled loans at Wichita, is the cost that it would take to writedown, for the Government to intervene, for you all to intervene and instead pick up the part between the loss they are willing to take and the debt that the farmers can cash-flow.

Mr. GUNDERSON. Mr. Casper, I know you understand the credit situation and how it operates well enough to know that what the Farm Credit System has to do is, one, determine how much in losses they can withstand personally——

Mr. CASPER. That's what I said, yes.

Mr. GUNDERSON. And, second, how much they are going to have to bring up in revenue from their system, not only in writing off assets which they presently have, but to pay the interest on those bonds to continue getting the money necessary. Now we are talking about a plan necessary to keep the system operating. In addition to that, you are suggesting that what we ought to do is come up with some type of system to help some of those borrowers in trouble who happen to be customers of the Farm Credit System.

I mean, we can't take money that needs to be used to keep the system alive and pay interest on bonds, and simply transfer that over here to the other side. We don't have that luxury, so I think clearly that's a minimum level we are talking about. What you're talking about is an additional amount.

Mr. CASPER. I don't believe it is.

Mr. SAUNDERS. Could I just respond briefly?

Mr. GUNDERSON. Sure.

Mr. SAUNDERS. I think that the thing you are concerned about is whether or not, within the jurisdiction of this subcommittee, you can address the real concern that the majority of the testimony from farmers here has presented, which is that without a price you can't solve this problem. Now I may be ignorant as to the process of our Government but it seems to me that one of the roles of this subcommittee is to investigate the situation, and what the testimony over the last 2 days has shown, without a doubt, is that there is a crisis. It seems to me that that information may change the way you look at it, and I don't think we're talking about a bill here yet. I think we are talking about what is the problem.

The way you are approaching the situation is to say, "We can't deal with anything but a bill for a bailout of the Farm Credit System." What I say to you is, what we have found out in the last 2 days is that the problem is much more severe, and it is the feeling of most of the farmers and the independent bankers that throwing money at the problem will not solve it.

It's kind of like—maybe it works different in Washington—but if I plant my corn, and in Wisconsin we have late frosts sometimes, and I get up in the morning and the corn is this high and it's frozen, I've got a crisis and I've got to go out and replant it. We've got a crisis. Maybe we have to go back and do some more work. That cannot be left out of the discussion. That's the point.

Mr. CASPER. Let me just add one thing. It seems to me, to clarify what I think is going on here and to respond to your remarks, it seems to me that what we are hearing is the possibility of transferring from the Federal Government to the Farm Credit System on the order of $5 or $6 billion. That was the proposal. What I am saying is, if you want to do that to a Farm Credit System that is willing to writedown the debt to some extent—they are going to lose some money, right?—don't do it with no strings attached. Send it over and tell them that it's to be used for debt restructuring, not for foreclosing on farmers. Surely, you know, the choices are not just send the money or don't send the money. You should be able to figure out a way of telling them what to do with it.

Mr. WELLSTONE. If I could just add one quick, quick thing, since I was in the position of representing an organization and without seeing their prepared testimony, it is not a particular plan that any of us are wedded to or a specific proposal. I know the Center for Rural Affairs is going to be testifying and they have, I think, some very interesting alternatives too, but I do think that what we are saying and that we all agree on pretty strongly, even coming to it from somewhat different directions, is that let's not have a bailout or whatever you want to call it which, in the process of helping one party—the lenders—just essentially hastens the massive foreclosure and exodus of family farmers. Let's have some accountability, and let's look at a debt restructuring program which is fair and equitable to both parties. We are trying to get at some discussion that will move us in that direction.

The second thing, and I think this is what Tom was trying to say, is that quite clearly as we look at that and how eventually that might be paid back, you can't separate that from price. Price is a central issue, and you can think about a debt restructuring program whereby farmers pay that back as they are able to cash-flow, which in turn is sensitive to price. Wouldn't it be nice for the Federal Government to have a positive incentive to become interested in agriculture becoming profitable again?

Mr. JONES of Tennessee. The time of the gentleman has expired.

Mr. Evans, you are recognized for 5 minutes.

Mr. EVANS of Iowa. Well, thank you, Mr. Chairman.

I have been listening with great interest to the testimony and to the dialog, and I would just like to say that I think you have got some very good points. I agree with you that the restructuring plan that has been discussed, if you want to call it that, the incentive is on foreclosure and liquidation. The incentive is there.

Mr. Casper, I think your fair credit plan diagram is a very useful diagram. I think it makes a very good point, and while I would think in terms of the practicalities of the situation within this subcommittee—I would change a few little words in there—I think the diagram is basically sound, and I want to assure you that as we go through the evolution of a bill, I am going to try to do what you want to do, which is greatly reduce the incentive to foreclose and liquidate and greatly strengthen the incentive to restructure debt and keep that guy on the land. I think you are right on, so I want to assure you all that as we go through this evolution of a bill, I don't think I am going to be a spokesman for precisely what you are talking about here but I sure am going to be a strong spokesman for that principle that you have espoused, and I want you to know that.

Mr. CASPER. Thank you, Mr. Evans.

Mr. JONES of Tennessee. Thank you, Mr. Evans.

Mr. Stenholm, do you have some questions?

Mr. STENHOLM. No, thank you, Mr. Chairman.

Mr. JONES of Tennessee. I have a comment or two I would like to make, but first let me project to any member of the panel or all members something that happened earlier today. I don't know if you were here or not, but the attorneys general from several of the States—Minnesota and Iowa, and we had a statement from another State, I believe Kansas—made some proposals to reform the Farm Credit System to make it more responsive to a borrower's right to due process. I am wondering if any of you have any comment, and I would like for it to be as brief, of course, as possible, on the proposals made by the attorneys general?

Mr. DAILEY. Mr. Chairman, I wasn't here to hear what their proposals were as far as reform. I will say this, having personally been through technically the part of how many rights you do have in, say, a PCA system or a Federal land bank system, as I understand the Farm Credit Act there is supposed to be a method of appeal currently for a borrower who can't get a loan. No place in this country have I ever found that a borrower has been given any appeal rights based on loan decisions made in his case. This is a very big danger. That system, somebody had said earlier that the system is screwed up. Well, it really is in relation to its dealings with farmers and farmers' rights. I see no farmers' rights at all. I could talk about this for about 4 hours, so I am going to stop right there.

Mr. JONES of Tennessee. Any other comment? Mr. Saunders.

Mr. SAUNDERS. Yes; if I could respond just generally, because I haven't seen the proposals, I think the question—the Farm Credit System obviously isn't proposing reform of its system. I think that it's necessary to reform the system, for what Mr. Dailey proposed. The problem is that dealing with farm credit means dealing with farm families, not just businesses, and that means that farmer rights are important. If you don't look at abuses and the way the system functions with an eye toward reform and democratic process, then you wind up with the history that we have had over these years, so just calling for reform, I support. I can't support the specific provisions because I haven't seen them, but I applaud it.

Mr. **Jones** of Tennessee. It might pay you to take a look at the testimony that we heard this morning from the three gentlemen. Well, one was not here, but it evidently is also as good a testimony as the other two.

Mr. **Wellstone**. Mr. Chairman, just a quick comment. I think that the notion of more due process and the notion of a Farm Credit System which isn't more centralized, but is more decentralized and more democratically accountable to the farmers, is a positive step in the right direction. I think it's one piece of a proposal or a set of proposals that we have to think about, and I would echo what the Congressman said. We also have to make sure, however, that what we do deals with the economic incentives in such a way that we are not helping one party and causing just massive foreclosures. So we also have to think about what kind of debt restructuring program will also work, because this is also a financial crisis in addition to some questionable practices by way of people's due process rights, so that's critical, too.

Mr. **Casper**. I really don't think that the issue fundamentally is really the question of due process. I think there is really no nice way that you can foreclose on farmers. Whether you do it nice or whether you don't do it nice, they are going to feel very bad in the end, so I think the real issue is the question of debt restructuring versus foreclosure that Mr. Evans has mentioned several times in these hearings, and I think that's the one that you have got to look at. If you are going to give them money, make sure that they restructure those debts and not foreclose.

Mr. **Jones** of Tennessee. Thank you, gentlemen.

Let me say this before I dismiss this panel. I really appreciate your being here. I am not sure how to take your testimony, as chairman of this subcommittee. I don't know if you are projecting some criticism to this subcommittee for what we have done in the past, or what we might do in the future. I am not exactly sure just what you said about that. I will know later.

But it just moves me to say this to each of you, that you are looking at four gentlemen who are sitting here at this table today who are all farmers. Every one of them, probably without a doubt, has their lifetime, what savings they have, invested in agriculture, the same as most likely each of you do. We are as concerned about the problem that's out there in rural America as you are, and I would say even more so, because we have had a double job to do. We are struggling back home to pay the taxes and to keep the land going, and then we are here in the Congress working in the interest of rural America everywhere, and we spend a great deal of time doing that. We feel like we have contributed something to the good of rural America by doing that. We are not altogether pleased with what takes place today, whether it be here in this Government, whether it be out there on my farm or your farm or in the export business or wherever it might be, but we are trying and we are doing the very best that we know how to get the job done.

I have one question to ask each of you: We have had hearings after hearings after hearings. This committee works hard. We don't know what time of day it is. We don't watch the clock, and when we finish this afternoon we'll not be finished because we have other things to do. I wonder how many of you have been here to testify before today? Just raise your hands, that's all you have to do, if you have been here before.

Mr. SAUNDERS. Before this committee?

Mr. JONES of Tennessee. Yes, sir.

That's what I'm talking about, folks. When things get rough, we hear from people such as you. You should have been here before today. We have been trying to restructure the Farm Credit System for a good while now. We had an update in 1980. We wrote a farm bill earlier this year. We had hearings all last year, and we had an update on the Farm Credit System in 1970. If we are interested in rural America and dedicated to the problem at hand, we need to come more often and not just come when an emergency has been created.

Thank you very much, gentlemen.

Mr. DAILEY. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. The next panel is Mr. Gene Severens of the Center for Rural Affairs, Walthill, NE; Mr. Duane Sand, Iowa Natural Heritage Foundation, Des Moines, IA; Mr. Mark Bredemeier, Gulf and Great Plains Legal Foundation, Kansas City, MO; and Mr. Roger Sledd, attorney, of Paris, KY. Take your seats, gentlemen, and we will be glad to hear the final panel on today's witness list.

Gene Severens is the first name on the list, on the panel today, from the Center for Rural Affairs. Gene is no stranger to this subcommittee or the full Agriculture Committee. We see Gene real often. He is of great assistance in his counsel and advice to the full committee and also to the subcommittee. Gene, we are glad that you are here and we appreciate the fact that you have taken the time out to be with us. You may proceed.

STATEMENT OF EUGENE SEVERENS, CENTER FOR RURAL AFFAIRS

Mr. SEVERENS. Thank you, Mr. Chairman. It's a pleasure to be here, and I commend the subcommittee for holding these hearings.

Mr. Chairman, if it is all right I would like to have my testimony introduced in full, whereas during this presentation I will skip a few sections in the interest of saving some time.

Mr. JONES of Tennessee. Without objection, it will be made a part of the record.

Mr. SEVERENS. Fine. I would like to skip, if I may, to the section entitled "Decapitalization of U.S. Agriculture."

American agriculture was overcapitalized in the 1970's. A host of tax shelters which overstimulated capital investment in agriculture, inflation, soft credit collateralized on the false hope of infinitely appreciating land values, and speculation in farmland development schemes combined to pour amounts of capital into agriculture that could not be justified on the sector's ability to produce income. We are now experiencing the tragic personal and family costs and the inevitable financial and institutional adjustment to that overcapitalization. In Nebraska we are in the midst of unprecedented farm liquidations and decapitalization, in which borrowers, lenders, and equity-holders alike are experiencing substantial capital losses.

Only Government action, I am afraid, can place controls on this liquidation and make sure that these losses are equitably shared.

I would like to skip to the top of page 2, please.

Three strategies: survival, restructuring, and rebuilding. In formulating Government action, we should take note of three general financial situations which farmers and lenders are or will be facing. Government strategies need to be separately fashioned for each of these different situations. Those three strategies are, first, basic survival and debt discharge strategies for farmers facing imminent liquidation or with very low net worth. This is one group of farmers and requires one type of strategy. Second, restructuring strategies for farmers who need to protect an eroding but still moderate net worth; and, three, stabilizing and rebuilding strategies designed to stabilize land values and provide farmland purchase opportunities for rebuilding efficient family operations.

It should be noted, Mr. Chairman, that public programs can be most easily designed for the first and third approaches. The second approach, restructuring of debts or assets, will make sense for many farmers and ranchers only if income improves. It is also worth noting that the first approach—basic survival and debt discharge—involves little public expense. Such strategies would work by improving access to bankruptcy or by redesigning liquidation laws to facilitate farmer-lender agreement on scaling down to manageable debt levels. Liquidation procedures as they stand right now are simply designed as a terminal event—the death of a farm.

Criteria for debt relief plans: Like an earlier panel that discussed some criteria, we have our own criteria. Farm debt relief plans at any level of Government must be consistent with properly considered public purposes and be carefully designed to assure that those purposes are fully served. We submit the following criteria for evaluating the many plans being submitted.

First, loss sharing: Farmers and ranchers, lenders and Government, all share some of the responsibility for or have assumed some of the risks of the current debt crisis. Any Government plan to absorb or postpone the coming round of capital losses should balance each party's ability to absorb additional loss, its responsibility for the current situation, its assumption of risk for the ongoing losses, and its affinity to the articulated public purpose being served by the relief plan.

Second, family farm and ranch focus: The longstanding purpose of Government farm lending programs has always been to maintain and create opportunities for efficient family-size farm or ranch operations. There is no reason that that public purpose should be suspended now. If there is going to be a public investment to absorb some of the loss, then that investment should be designed to work through family farms and ranches, and not be direct transfers of cash which are controlled largely by lenders.

Third, controlled liquidation: Public debt relief programs should not encourage uncontrolled or unnecessary liquidation but should promote selective scaling down of assets. Unplanned, unilateral liquidation is a drastic action which affects personal livelihoods and family and community well-being. It is also inefficient because it arbitrarily breaks up an integrated set of farming assets and typically returns to the secured lender less than the use value of the asset.

Fourth, accessibility: Information about and access to any rescue plan should be readily available to all parties. Access to programs and procedures which are unilaterally controlled by lenders is not only unfair, it also promotes arbitrary and inefficient results. We note that agriculture has a long and successful tradition of using local farmer committees to determine access to programs. We think this device should be considered for any Federal farm relief measure.

The fifth criterion, cost effectiveness: Any public funds allocated to the debt crisis will be limited and should be used so that as many people as possible will be benefited in a meaningful way. Typically this might mean, depending on the program, that modest ceilings should be placed on benefits so that the available finite resources are not absorbed disproportionately.

Finally, avoidance of past abuses: In designing any rescue plan, past abuses and shortcomings will be identified. Every effort should be made to prevent and correct those abuses.

My final section: The Farm Credit System—out of control. The desperate financial conditions in agriculture should be serving as an opportunity to reassess the total role of Government in agriculture and develop a comprehensive program that included tax and income policies along with credit programs. If the current discussion focuses only on credit and the Farm Credit System in particular, then at the very minimum, it should take this opportunity to thoroughly evaluate the last 20 years of Farm Credit System performance and reassess the public purpose served by such a system.

We think the Farm Credit System is out of control in more ways than just financial. It is out of congressional control, and the system's managers have lost sight of the cooperative principles under which the system was created, and they have lost sight of the everyday farmer and rancher the system was created to serve.

The irrational drive for consolidation and centralization of control is perhaps the most disturbing trend. Project 1995 and high-level Farm Credit Administration administrative action indicate that current management has stood cooperative principles on their head. The system was designed to solve the unique credit needs of everyday farmers and ranchers by linking them with money markets on the east coast. Current management, however, seems bent on reversing this link by rejecting these everyday farmers in favor of more easily financed blue-chip producers. Mr. Chairman, the system was created to serve farmers, not vice versa.

As the subcommittee knows, many FCS districts face merger votes in November. Mr. Chairman, we think this merger is an attempt to preempt Congress by limiting congressional options by a presumed "yes" vote for merger. This merger not only has little merit, it is poorly timed. The merger vote is different in each district and is a piecemeal approach at best. We urge Congress to develop a comprehensive rescue and reform plan for the system and disregard the piecemeal results of the merger vote.

On the merits of merger, we find little reason to support it. In addition to effectively ending any chance of meaningful local control, we think it increases the overall vulnerability of the system. For example, a few years ago the Omaha district FICB, which includes Iowa, Nebraska, South Dakota, and Wyoming—one of the current trouble spots in the system—approved enormous loans in the Valentine, NE PCA for irrigation development in north central Nebraska. The PCA was liquidated just last year, and we have learned that of that PCA's $12 million worth of nonperforming loans, over $8 million—all approved by Omaha—were held by a single, now bankrupt, irrigation developer. That one borrower brought down the Valentine PCA and many of its other borrowers. Local merchants and local government were also victimized by this one loan decision. If the proposed four-State merger had been in place earlier, perhaps the entire four-State area would be in more trouble than it is now.

Mr. Chairman, the Farm Credit System wants desperately to keep beyond Congress' control. The system in its modern era has a history, in my opinion, of defying Congress. For example, in the 1980 Farm Credit System amendments, Congress created the special "Young, Beginning, and Small Farmer and Rancher" Program. The system responded, all right, by authorizing higher interest rates for that group of farmers. I suggest that that result is a perversion of Congress' intent and stands as a warning to this subcommittee that any FCS reforms adopted must be carefully legislated to prevent this type of cynical manipulation.

Mr. Chairman, as you well know, this is an extremely complicated issue. Our organization is working with others to develop a package of FCS reforms. We look forward to sharing them with you in the very near future. Thank you for this opportunity to provide testimony. Thank you.

[The prepared statement of Mr. Severens appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Severens. We appreciate your being here and your contribution.

The next witness is Mr. Duane Sand, Iowa Natural Heritage Foundation of Des Moines. Mr. Sand, welcome.

STATEMENT OF DUANE SAND, IOWA NATURAL HERITAGE FOUNDATION

Mr. SAND. Thank you, Mr. Chairman. I am honored to testify before you, one of the foremost conservation leaders in the Nation.

While the farm credit crisis is the major issue of this hearing, I am sure that more in this room are also extremely concerned about the growing national debt. My remarks will concentrate on a conservation and credit proposal that makes sense at this time of deficit spending.

Historically, deficit spending has been a powerful tool to moderate economic recessions. In the case of agricultural credit, there is reason to believe deficit spending is now needed. The Wharton

Econometric Model forecasts a loss in income to the Federal Government between $14 and $22 billion by 1993 if the Federal Government fails to respond to the farm credit crisis.

Timely intervention would also save several billion dollars that may be required to capitalize the Farm Credit System and the Federal Deposit Insurance Corporation, and to cover Farmers Home Administration loan losses.

Congress has the choice to pay now or pay later, but Congress must act now if it wishes to slow the future growth of the Federal deficit.

This investment must meet four criteria to be fair and effective: First, it must channel funds to financially troubled or insolvent producers so they can pay lenders who also cannot meet obligations.

Second, it must prevent excessive devaluation of agricultural assets so that even more producers and lenders do not become insolvent.

Third, it must be reasonably fair to other competitors in the marketplace; and

Fourth, it must assure that current taxpayers or future generations who will eventually pay for the program are getting the most for their money.

The Iowa Natural Heritage Foundation has researched such a proposal involving the Federal purchase of conservation easements on agricultural land subject to foreclosure. The conservation easements concept was placed in the 1985 farm bill by this committee to restructure Farmers Home Administration loans. Additional easement purchases authorized in H.R. 3557 would slow the loss of asset values in severely depressed land markets by keeping farms off the market and by encouraging private purchases of land. In addition to these benefits, the public receives long-term conservation of soil, water, and wildlife resources.

A conservation easement is a legal agreement in which the landowner relinquishes the right to certain specified uses of the land. Easements can permanently protect conservation interests while leaving the land in appropriate agricultural production under private ownership and management. The Federal Government has purchased conservation easements for over 50 years, and further encourages their use by allowing tax deductions for donation of easements to conservation agencies or organizations.

The purchase of conservation easements is fair because it is not a giveaway program. The Government is purchasing interest in real property which can be sold back to a landowner if there are higher priority conservation needs. During the period it owns the easement, the Government will receive the conservation benefits it negotiated. In many cases it will also experience some savings in farm price support programs because of reduced production required by the easement.

While partial sale of assets will allow many producers and lenders to stay in business, the survivors will be determined by the marketplace rather than the Government. The sale of easements will not save all farmers or lending institutions, but will stabilize the land market so more will have collateral or asset values needed to remain in business. Our opinion polls indicate about half of the land subject to foreclosure could be kept off the market through a conservation easements program.

Purchase of easements offers a politically acceptable alternative for assisting financially troubled individuals and lenders without being unfair to their competitors. Such targeting of funds is essential, since price support programs spread assistance too widely to prevent a financial crisis.

Our research shows the Secretary of Agriculture currently has authority to purchase conservation easements. Under a barter system, using surplus commodities for payment-in-kind, the program could be implemented immediately without appropriations. The program could be administered through the personnel and procedures of the Agricultural Conservation Program, which is a cooperative effort of the ASCS and the Soil Conservation Service. This existing authority, process, and personnel may be essential for the timely salvaging of the Farm Credit System should its bond market fail.

With all these points in mind, it appears that a conservation easements program would be fair and effective but, most important, it is a bargain for present and future taxpayers who pay for deficit spending. Americans will be paying for the farm credit crisis long after it passes. Unlike other proposals, the purchase of easements conserves our soil, water, wildlife, and natural areas for the benefit of those who follow.

Thank you for the opportunity to testify, and I request the attached article be included in the record.

[The prepared statement of Mr. Sand appears at the conclusion of the hearing.]

Mr. **Jones** of Tennessee. Without objection, it will become a part of the record.

Thank you very much, Mr. Sand, for a very splendid statement. I am sure that as we proceed the subcommittee will take a further look at your statement.

Our next panelist is Mr. Mark Bredemeier, Gulf & Great Plains Legal Foundation, Kansas City, MO. Mr. Bredemeier, you are welcome. You may proceed.

STATEMENT OF MARK J. BREDEMEIER, GENERAL COUNSEL, GULF & GREAT PLAINS LEGAL FOUNDATION

Mr. **Bredemeier**. Thank you. Mr. Chairman, my name is Mark Bredemeier, and I am general counsel for the Gulf & Great Plains Legal Foundation. It is a public interest law foundation based in Kansas City, MO and serving eight States in the Midwest, including the North and South Dakotas, Nebraska, Kansas, and Missouri. We thank you for this opportunity to present our analysis of the crisis facing the Farm Credit System, and I think the subcommittee will realize that we are presenting at this time a viewpoint that I don't think has really been heard by too many members of this subcommittee throughout the 2 days of testimony.

I might point out that, in addition to the summary analysis that I provided as testimony and that I am going to be skimming here orally, I also am submitting on behalf of the foundation the written testimonies of three individuals who are familiar with the financial crisis affecting today's agricultural economy: John Gill, who is a farmer in Platte County, MO; Ted Abele, an agricultural consultant who serves a 17-State region in the Midwest and who was formerly involved with the Farm Credit System; and Dr. J. Bruce Bullock, who is professor and chairman of the Department of Agricultural Economics at the University of Missouri-Columbia, also a former research manager within the Farm Credit System, and a noted author of numerous studies and reports which I will allude to here later. Included as exhibits to Dr. Bullock's testimony are two reports prepared by Dr. Bullock and the Food and Agricultural Policy Research Institute. At this time, Mr. Chairman, I offer into the record these testimonies and exhibits.

[The prepared statements of Mr. Gill, Mr. Abele, and Mr. Bullock appear at the conclusion of the hearing.]

Mr. JONES of Tennessee. Without objection, they will become a part of the record.

Mr. BREDEMEIER. Thank you, sir.

I will move on from my written testimony. At the time this was prepared a month ago, it appeared as though there was going to be a real question as to whether or not our national leaders were going to focus on the real problem that we are facing today. We have a lot of media attention and we also have a lot of attention by our national leaders on the symptoms of the problem—the precarious welfare of farmers and their families, the looming insolvency of more and more agricultural lenders, and the uncertain future of rural America.

These are very important things but they are symptoms of the credit problem. The cause of the credit problem, which I think has been clearly established by the members of the committee and many of the panelists so far, is excess debt. That is an inability by farmers to repay the debt that is already there. We need to focus on this and understand that because of the presence of an enormous volume of debt, it's a problem because this debt cannot possibly be repaid by farmers this year or next year or, for many, many farmers, ever. That is even with farm product price increases, higher price supports, zero interest rates, loan guarantees, expanded export markets, more credit through expanded Government loan programs.

The failure to distinguish the symptoms from the cause is going to lead our national leaders into taking the primrose path of throwing good money after bad in an honest and sincere hope of trying to help everybody. Taking such a path we think ensures a potential for even greater economic disaster for farmers, for lenders, and for the American taxpayers.

I have been in and out of here for the past couple of days, and until Mr. Sand gave his discussion I really haven't heard too many people recognize the fact that, like any other business in this country, some farmers are going to go under. Five percent went under this year. Ten percent or so are expected next year, and it may be more. I think what we need to do is focus on how we are going to acknowledge that the market and the market forces are doing something right now, and all of the farm programs that the Government is instituting, and all of the farm credit and farm finance programs that this committee and this Congress may institute are not necessarily going to prevent certain market forces from taking place.

In a prophetic report prepared by the Food and Agricultural Policy Research Institute, FAPRI, this past March, Dr. Bullock, the chairman and agricultural economics department professor at the University of Missouri in Columbia, not only identified the cause and severity of the impending farm credit crisis way back then—like many others—but he discarded the many panaceas that have been proposed as easy ways out. He basically boiled it down to two acceptable or possible methods: debt removal, which is going to be deciding between the borrower and the lender and, yes, the Federal Government if necessary and as some people propose, how you are going to redistribute the wealth losses. What this boils down to, the narrow question, is how much of the farmers' and the system's investors' losses will the Federal Government underwrite.

Parenthetically, we might add at this point, what about private commercial lenders? You have heard them here. They are here basically asking for some protection on their own, and rightly so, if the system is going to completely get it. I guarantee you that after the system gets help and after private lenders get help, agribusiness is going to be here, because I was in a meeting last week in Kansas City, in and around a number of commercial lenders and agribusinessmen, and they are hurting too, and you know that.

Where do we draw the line? After agriculture, where do we draw the line? We have thrift and loans in serious trouble in this country. We go on and on and on. A lot of analogies are drawn to Chrysler and New York City. We have to be careful that we're not drawing conclusions based upon apples and oranges. Maybe we ought to question whether or not we should have done some of the things we have done in the past.

But, as an alternative to this approach of simply redistributing wealth losses, the better alternative proposed by Dr. Bullock is, simply let the chips fall where they may. That's a very difficult decision to make, there is no question about it, and many will say that it's harsh, it's mean, it's vicious, it's cruel. But what is going on right now is something that is taking place in the market, and query whether or not this type of activity is going to be taking place to some extent no matter what this subcommittee and no matter what Congress does.

Many are crying out the need for a Federal bailout. Presumably this would involve an infusion of capital into the system to continue or to expand present loan and credit programs. The rationale, of course, is plausible and even admirable. They are saying that foreclosures and bankruptcies, bank failures, and the rural regeneration that would follow is just too much of a price to pay right now, but again, query whether or not this price is going to have to be paid anyway. We have too many farmers and too much acreage in production. That's not going to change, no matter what this committee or Congress does.

Five percent of our farmers went under last year. Ten percent are expected to do the same this year. Perhaps that's going to increase. Many small farmers, those producing less than $100,000 a year in gross sales, already rely on off-farm income rather than farm income to get by. I think USDA charts show that they do that sometimes at an income level greater than the national average. Rural communities are already suffering the effects of a changing agricultural industry, as larger farms no longer trade on Main Street but are going to the cities. All this is true now, today, and without a bailout.

The question is, will more money, more credit in the system resurrect the plight of the economically nonviable small farmer and thwart the dynamics of our changing farm economy? We think not. If we want to help the small farmer, let's craft a direct relief program for him. Help some of the people who just aren't going to cut it in our changing economy. Help wean them from farming, and do it in a way that is going to help them and directly help them—not passing it on through more and more of the bureaucracy or setting up new programs, but help them directly.

If we are worried about the economic future of rural America, let's encourage other forms of rural development like manufacturing and other things that are out there. We need to relieve rural America from the ominous dependency they have on agriculture. Agriculture is always going to be there in this country, and it is always going to be a very important, thriving industry, but the agriculture that some people think is going on right now isn't going on right now, and it hasn't been the way agriculture has been going on since the thirties, forties, and fifties, and it is not going to be the way agriculture is going to be in the eighties and nineties and into the next century.

Simply put, a shakeout in our agricultural economy is underway, and more credit will simply exacerbate the lending crisis. As Dr. Bullock cautions in his report, providing additional debt to these farmers is analogous to putting more water in a swimming pool in an attempt to save a person observed to be drowning in water over his head. At this point I might point out that the only proposal I see on the table, other than the previous panelist over here on my left who mentioned his own proposal, but as far as the Farm Credit Administration's proposal, the $5 billion line of credit does not go to the problem that I think each member of this subcommittee has already addressed. That is excess debt and inability to make debt repayment. This revolving line of credit is not going to do anything to do that.

People are saying, "We need to increase the income." Well, that's fine, but the question is, can this Congress through any kind of farm programs increase income to the level necessary to save farmers all the way across the board? Again, as I say, a shakeout is underway. Pretty soon, 5 or 10 years down the road, when supply and demand is going to be back more in line and we will have a more reasonable allocation of farmers in this country to produce what is actually needed to be purchased, prices are going to come up on their own. We are going to enter into the export market again, competitively, but that is not going to take place if we continue to go on as we are doing.

I might quickly point out that Ted Abele, the agricultural consultant, who is acutely aware of the financially stressed farmers in the Midwest, has stated that it is unreasonable to assume that the Federal Government can or should even consider trying to salvage all of the financially troubled farmers, agribusinessmen, or commercial banks which have no reasonable likelihood of recovery. He also points out that the Government, like a drug pusher in a schoolyard, has never been a close and trusted ally of the American farmer. This isn't to condemn people on this subcommittee or in Congress. It is just a recognition that sometimes the more we try to do things, the more harm we are actually doing in a free market society.

What he concludes is, "But, like an addicted teenager, we have come to rely on subsidies, transfer payments, and guarantees afforded by the Government. Because of the many strings the Government has attached to the Federal 'fix,' we are inexorably tied to programs because we think we cannot survive without them."

I might conclude at this point that at the heart of the Farm Credit System's liquidity crisis and any proposed Federal bailout that is agreed upon now or in the future, is the challenge of whether a move to a more free market agricultural system will ultimately be better for today's farmers—those who survive, and those who are forced to take up a new livelihood—than what we have now. Stopgap salving of the status quo will only forestall the inevitable economic day of reckoning for many of this country's farmers and lenders. It is time to face facts, recognize that the pool of debt is already overflowing, and accept that as yet we have no real survivors.

If I may note—it is not in my report—I have listened to a lot of this. I don't want this to sound as though it is harsh and we don't care about farmers, but the question is this: If "Farmer Jones"—I don't mean any disrespect to the chairman, but everyone talks hypothetically about "Farmer Jones"—if "Farmer Jones" owes $100,000 right now and we prop him along through any kind of a program that we have right now, and 3 years from now—we can't expect too much better of an economic climate and interest rates and bumper crops and export markets—and if 3 years from now things aren't improved, "Farmer Jones" is going to owe $150,000 or $175,000 and he is not going to be in any better shape to bail himself out.

Now who is really the friend of the farmer, that particular farmer? Someone who is going to help certain people in the farming community realize when it's time to get out. I think that's an approach where we may be at, and a unique time that this Government and this Congress may be at right now, in the coming year or two.

Thank you.

[The prepared statement of Mr. Bredemeier appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you, Mr. Bredemeier, for a good statement. We appreciate it, and we will take a good, deep look at the contents of all the statements that you have offered here.

Mr. BREDEMEIER. Thank you, sir.

Mr. JONES of Tennessee. Now there is one other on the panel, Mr. Roger Sledd, attorney, Paris, KY. Mr. Sledd, we are delighted that you are here. Although you are last, that doesn't mean a thing in the world. We are glad you're here just the same. You may proceed.

STATEMENT OF ROGER B. SLEDD, ATTORNEY, ON BEHALF OF DIRECTORS AND STOCKHOLDERS, FOURTH DISTRICT ASSOCIATIONS

Mr. SLEDD. Thank you, Mr. Chairman. I appreciate the opportunity to be here. I have sat here for the 2 days and listened to this testimony, and I must tell you that I do not have the benefit of the drug or opiate that the Department of Agriculture seems to be under the influence of, or that the Farm Credit Administration was under the influence of, until the first week in September. My testimony is based upon my experience as a farmer for the fourth generation on a farm in central Kentucky, as an attorney who has experience in representing farmers, and also I have served as a special counsel to the Department of Banking and Securities in the State of Kentucky. The suggestions along the model of the FDIC have special significance, I think to me, at least, having that regulation experience.

Mr. Chairman and members of the subcommittee, I am here on behalf of the directors and stockholders of the fourth district associations concerned about the misrepresentations, coercion, and intimidation that has been exerted on the directors of the associations of the fourth district to compel them to vote for the consolidation of associations into one joint managed land bank and one production credit association in Louisville, KY.

At a recent meeting in Paducah, KY, 55 of these directors favored the 28 joint association plan that was proposed; 4 favored the one PCA and 1 FLBA association plan; and 4 did not vote for either plan.

I cite these numbers to show how compelling the opposition is to the one association plan among the directors of the associations.

It is not our intention to oppose or minimize the need for help that exists in the Farm Credit System. Rather, Mr. Chairman, we are here to ask you and the members of this subcommittee to use your oversight authority and influence to require the fourth district in Louisville, KY, to withdraw the consolidation plan that has never been formally presented to the stockholders of the associations, and either permit the stockholders to vote on the 28-association plan as originally proposed or amend the statutes to make clear that the associations can be consolidated and unified in the manner and form presently being attempted.

Under no circumstances should the plan be permitted to be submitted to the stockholders under the air of intimidation and misrepresentations that currently prevail. To permit this vote and the further dilution of control and input from the local borrower-stockholders will have major consequences on the efforts to stabilize and maintain the Farm Credit System, our opinion.

The increase in interest rates in the fourth district is a burden that the farmer borrower cannot shoulder, and has had the consequence to drive good loans out of the system.

In January 1985 there were $4.7 billion in loans outstanding in the fourth district. On September 30, 1985, there were $4.2 billion in loans outstanding, a loss of $538 million in outstanding loans which in large measure was caused by the ill-advised interest rate increase. The impact of this paydown in loans can only be estimated. It is clear that only creditworthy loans attractive to other institutions have been lost at lower rates. Not only did the system lose the good loans, but accruing interest at 13.25 percent or an effective 14 percent rate when the farmer is operating in an agricultural economy that does not even return production costs, is engaging in self-deception and mismanagement in its highest form. Put simply, the fourth district may accrue interest at 14 percent but the borrower-stockholder simply cannot pay it.

As you well know, Mr. Chairman, the farmer today is in a critical situation brought on by a strong dollar that has encouraged imports of cheaper farm products, and discouraged the export of American farm products; a period of deflation after rapid inflation which encouraged borrowing and expansion by well-intentioned farmers attempting to protect themselves from inflation; and a policy of free markets with an overcapacity of production that seems to be limited only by the American farmer's imagination and capacity for output. Specifically, whether we agree or disagree with the present agricultural policies or those that preceded them, the American farmer today is dealing with a situation that good management and better production efforts cannot solve, at least in the short term.

In the last 8 months, I have seen the overproduction of grapes in the Napa Valley, the devastation of the citrus crop in central Florida by 2 years of successive freezes, the Great Depression in the Grain Belt, and the loss of real income in the tobacco-producing States. Sir, the present agricultural crisis is not confined to any geographical area, and represents the most compelling and critical need in our country today. The fallout from the absolute collapse of the agricultural sector of the economy, which includes the Farm Credit System, will have devastating consequences on land values, tax bases of State and local governments, and the collapse of our financial institutions, not to mention the human suffering and costs.

There are no easy solutions. The alternatives at best are not without serious consequences, but the delay will only make more expensive the remedies and input that must ultimately be provided.

I submit, first, the local control of the Farm Credit System must be maintained and strengthened by requiring the continuance of the election of the local boards by the borrower-stockholders.

Second, a change in the method of electing the district bank boards to reflect the true representation of the board by those who own it and not those who use it. Specifically, the borrower-stockholders should elect the boards of directors of the district banks in proportion to their contribution of assets to the district bank on an annual basis.

The hardheaded, conservative control by those who own the system will tighten the controls and require the system management to provide a workout and management of existing loans on the local level.

The erection of expensive buildings on the district bank level, filled with overpaid managers mumbling about the plan of 1995, has no place today. The large corporations have no interest in operating businesses that cannot get a profit to the bottomline.

Third, we need to define a clear line of demarcation between the management and regulation of the system on the national level. The model of the FDIC would be a start in terms of separating the functions of the Farm Credit Administration and ensuring that the regulator is not also the manager of the system. This has caused excesses and abuses which have loosened the control needed to ensure the continuance of the system. There is need for strong national regulation of the system but, in our opinion, we have asked too much of the present FCA, and we need to define and limit the control of the FCA management function, and look to the local borrower-stockholders boards on the local and district level for authority and responsibility.

Fourth, the focus of this subcommittee should be to help the Farm Credit System. The needs of commercial banks, insurance companies, and other lenders are a part of the total package. However, the Farm Credit System can be helped by specifically looking to the 1933 Emergency Farm Mortgage Act, and I ask this subcommittee to focus on that package of legislation that was created in 1933 in the debts of the Depression. The advantages of that act are, one, it has precedence; two, it worked; and three, it is comprehensive in its approach.

Specifically, it provided for a buy down of interest rates; it deferred principal payments; and it wrote down a portion of the debt in exchange for a promise to make future payments.

The cost of this proposal cannot be estimated without more and better numbers from the FCA. However, there is one thing I am absolutely sure of: The failure to act forthrightly, courageously, and soon, will only increase the cost of saving the major component of agricultural lending, a system that ultimately cannot be permitted to fail without the most serious of consequences to all Americans, not just the farmers.

Thank you, sir, for your time and consideration.

[The prepared statement of Mr. Sledd appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Sledd, for your statement. We do appreciate each one of you gentlemen being here, and I assure you that we will all take a good look at your total statements before we do anything about legislation.

Mr. Stenholm, you are recognized for 5 minutes.

Mr. STENHOLM. Mr. Severens, on page 3 of your testimony you suggest that agriculture has had a long and successful tradition of using local farmer committees to determine access to programs. Can you go a little bit further on who you're talking about there?

Mr. SEVERENS. Well, I guess I had primarily in mind the ASCS county committees, which are elected by the farmers in the county and are the decisionmakers; the authorities in the local ASCS offices that determine eligibility for benefits administered by that particular agency. I also had in mind county committees of farmers that were used during the Depression. Some of them had State authority. I believe some of them may have even been created under the authority just mentioned by the last panelist, under the Frazier-Lemke Act, whereby these farmer committees acted as mediation boards, resolving disputes or resolving disagreements between farmers and their lenders.

I believe North Dakota has a system in place now of farmer mediation boards that have some authority, although a little bit on the weak side, to resolve some of the differences. They don't have a stick so much as they have a carrot. They can hold out access to a special program sponsored by the North Dakota State Bank which will help in a principal writedown, and in order to gain the benefits of that program they have to go through the mediation board and be willing to offer some concessions to the particular farmer that has brought the lender to the mediation board.

Mr. STENHOLM. Mr. Sledd, you make a pretty startling suggestion on page 3 when you suggest doing away with the one-man-one-vote principle in cooperatives and going to a vote by volume. That is pretty much of a departure from cooperative philosophy in the past. I guess my question comes to you, reading between the lines and not knowing a great deal of what is going on in the Louisville district, but just guessing a little bit based on our Texas experience, what you are talking about here is a little disagreement between the Federal land banks and their participation in voting for district directors and the production credit associations. Am I correct?

Mr. SLEDD. Yes, sir. I think some of the real problems that the Farm Credit System has with the local borrower-stockholders are a result of the train getting off the track and these boards being more attuned to the management rather than to the stockholder-borrowers. It seems to me that the best way to get the attention of these boards is to have them elected by the local stockholder-borrowers in proportion to the contribution that they have made to the district banks. Now the Texas proposal is one that we can live with, and I think it is immeasurably better than the present election of directors on the district level.

Mr. STENHOLM. Would you also, then, support taxation of Federal land banks on profits, where today you are not taxed, whereas production credits are taxed, in order to balance that equity? Are you supporting taxation of Federal land bank profits?

Mr. SLEDD. No, sir. I don't know of any land banks that have got any profits to be taxed today, but I think you can maintain the cooperative exemption and provide for the election of the directors by stockholder-borrowers. I don't think you have to lose the tax exemption status without changing the method of the election of the directors.

Mr. STENHOLM. I would encourage you, and then I would like to have you report back to me personally what you would find out. Maybe we would be interested, but I've heard this same argument professed, and we have a lawsuit in Texas which constrained me from asking questions of my Texas representatives yesterday. But it is interesting when you find, if you would apply the same tax rate to the profits in Texas for the Federal land banks that the production credit associations have paid, that wonderful balance sheet and that dollar volume that you refer to, in Texas you will find that that dollar volume and that profit in what you are asking for will evaporate. It is purely and simply, almost to the dollar, the tax advantage that our land banks have, that our production credit associations do not have, that causes this imbalance. I wish you would check it in the Louisville bank and see, since the PCA's went under taxation, income tax, if you will go back and compare the land bank results, what the results would be in Louisville. I would be curious to know. I know what it is in Texas, and that's why I can speak with some certainty there.

Mr. SLEDD. Well, I don't think the land banks can survive without the tax exemption, certainly in the short term, and I am not proposing—the only thing is, today the management of the district bank tells the local boards what to do, and it is passive control by the stockholders that has created the abuses that you have heard farmers come here and testify about. I submit to you that if there is some way to get these boards responsive to the stockholder-borrowers, you won't have that political problem that exists today. I think that is one of the major changes that needs to be made in the course of straightening the furniture up and redecorating the house, but I think the infusion is also necessary.

Mr. STENHOLM. I don't quarrel a lot with your last statement but I do think we want to think long and hard before we eliminate the one-man-one-vote concept and principle.

Mr. SLEDD. Well, I hope that I'm saying one man-one vote in here. I favor the Jeffersonian approach to government.

Mr. STENHOLM. With all due respect, Mr. Sledd, when you say specifically, "The borrower-stockholders should elect the boards of directors of the district banks in proportion to their contribution of assets to the district banks," you are taking away the basic premise of one man-one vote. You are talking about voting dollars and assets, and not one man-one vote.

Mr. JONES of Tennessee. Thank you, Mr. Stenholm.

Mr. Evans, you are recognized.

Mr. EVANS of Iowa. Well, thank you, Mr. Chairman.

I want to thank all four members of the panel, and then go on from there as an Iowan and exercise my natural prejudice and focus on Mr. Sand, who is also from Iowa, and his proposal, and emphasize for the benefit of the chairman and the gentleman from Texas that one of the few or perhaps the only original idea to come out of this hearing is the one that Mr. Sand brought forward today. It is a natural extension of what we did in the farm bill under Mr. Franklin's proposals, of going on to make greater use of various types of conservation easements.

The Iowa Heritage Foundation has pointed out very accurately that one thing that many farmers who have large debts have that they can sell without interfering with their operational functions on that farm are various types of public easements on that property, and that that can be used as a device in some circumstances to help settle debts. I was astounded the other day, Mr. Chairman, in talking to some of the people from the Department of Interior, to learn that something generally along these lines was used in the thirties. The Department was saying;

> Do you know that in the thirties there was a program where a person in debt on land could sell the mineral rights on that land, but the sale of those mineral rights to the Federal Government would not be effective for 50 years?

So right now the Department of the Interior is scouting around, trying to find all of these mineral rights that were sold to the Government 50 years ago, and they are having an awfully hard time doing it.

Well, this is not precisely the same thing, but I would just commend Mr. Sand for carrying this another logical step, and I think that as we go through the next few months of looking at devices that might be useful in reducing debt—and particularly, I think, Mr. Chairman, debt to the Federal Government, and particularly debt to the Farmers Home Administration—that this may be a device that we can put to good use.

I thank you very much for yielding to me.

Mr. JONES of Tennessee. Thank you, Mr. Evans.

Would it be appropriate for the chairman to say that within the last few days one of our subcommittee members, Mr. Evans, has introduced a bill that is very similar to the Iowa Heritage Foundation principle? Would you elaborate on that?

Mr. EVANS of Iowa. Well, let's give credit where credit is due. As a matter of fact, Mr. Chairman, they wrote it. OK? [Laughter.]

Mr. JONES of Tennessee. That's up to you. I wouldn't say that. I didn't know, but anyway, maybe you deserve some commendation for it. At least this subcommittee without a doubt will be taking a look at it.

I am going to focus on Mr. Sledd only, and one question at that, because he is from the Fourth District and that's my district, and it's in trouble as some others are.

Mr. Sledd, on page 1 of your statement you plead with the members of this subcommittee to use its oversight authority and influence to require the Fourth District in Louisville to withdraw the consolidation plan that has never been formally presented to the stockholders of the association, and either permit the stockholders to vote on the 28-association plan as originally proposed, or to amend the statutes to make clear that the associations can be consolidated and unified in the manner and form presently being attempted.

Now my question to you, Mr. Sledd, is, is it not true that the Louisville district has scheduled a vote similar to this in December, to give all the 170,000 Louisville borrowers the right to say whether they want to proceed with one PC and one FLBA or not?

Mr. SLEDD. Yes, sir; that vote is to be, it's my understanding, on December 12, but the problem is that all of the announcements and the literature were basically addressed toward a 28-association plan, and it wasn't until the early part of June that they changed their course and track and went to this 1-association plan. As a result of the intimidation that has been exerted on the directors and the misinformation that the stockholders currently have, we don't feel that the proper atmosphere exists for the stockholders to make an intelligent vote.

We think that we need to back up, especially in light of these hearings that are going on and the possibility for some structural change within the Farm Credit System, and have this vote after we have an opportunity to look at what the changes are and how they will affect the management in the Fourth District. That's why we are asking that the management of the Fourth District be asked to back off of this vote on December 12 that they are requesting.

I might add, Mr. Chairman, that this vote indicates that the directors of the PCA's and the Federal land banks in the Fourth District have very serious reservations about the plan themselves.

That's part of the problem, is the way that the management has attempted to impose this upon the directors of these local associations and upon the stockholders. I think that the experience in Jackson, MI, if we could get the benefit of the gentlemen from Mississippi and Louisiana up into the Fourth District, we may be able to move toward the one association plan, but so far the imposition and the methods used by the management has created great resistance among the stockholders and, significantly, among the directors. That's why I am here, is because they asked me to be here.

Mr. JONES of Tennessee. Well, according to the testimony of the gentleman from Mississippi yesterday, I thought he said—and I can stand corrected if necessary—that he was available to help if and where needed, because if he didn't do a super job of selling the system that they have inaugurated at Jackson, MS, why I don't believe I know what I'm talking about. I thought he did a super job.

Mr. SLEDD. Well, I couldn't agree with you more, and——

Mr. JONES of Tennessee. I believe I would employ him, just——

Mr. SLEDD. I was going to say, we have very meager funds available, and we would a whole lot rather use them to employ him as a messenger rather than have to expend them for the "Lawyers' Benevolent and Protective Association," which looks like what we may have to do if we can't get some delay in this vote.

Mr. JONES of Tennessee. Having had some experience with the wheels of Government, and no doubt you have had some, too, the way they turn, I think I would resort to a motive like that rather than to wait in what this subcommittee or somebody else might improvise to get done at any early date, because our cup is rather full right now.

Thank you, gentlemen, for being here——

Mr. STENHOLM. Mr. Chairman, would you yield for one question?

Mr. JONES of Tennessee. Yes, I would.

Mr. STENHOLM. I want to ask Mr. Bredemeier one question. If I got the gist of your testimony—and I am just briefing through Mr. Bullock's statement, and I have read some of his work before—but did you suggest that what we ought to do with the Farm Credit System is just let it sink, if that is what is going to happen, and then pick up the pieces?

Mr. BREDEMEIER. At this point in time, and I think Dr. Bullock points out in his report and in his two studies, the second study is based upon FAPRI and a Wharton macroeconomic analysis, and it looks at the potential damage to the overall economy as well as to the system, and it is workable. And yes, the proposal is that by stopping the flow of credit and requiring the transfer of the losses, that the system can survive. It won't survive in the way that we know it right now, and it may not be the same 2 or 3 years from now, but the system itself can survive. I think the point is that if we want to try to preserve the system we have right now, it is just unreasonable in today's agricultural market to expect a system with this expansive a loan program.

I note in the Governor's statement yesterday for the Farm Credit Administration, where he talks about so much time being spent on restructuring nonperforming loans and things like that, and not enough attention to creditworthy borrowers, and that is the key. So much of the attention of the system still is devoted to—you hate to say "uncreditworthy"—but people who are not performing and probably won't perform, no matter what else you do. By not doing anything right now, you are going to force the system to focus on salvaging those who can be salvaged.

One of the ironies that I have in listening to all this testimony is, we want to give a revolving line of credit for this system so that we can make the bondholders and the investment market secure, and we want to have that line of credit there in any other loans going to the system so that they can work things through, but we don't want to foreclose on any farmers. We want to keep every farmer there, everybody. Moratoriums, we are talking about national moratoriums on farm foreclosures and things like that, and yet we don't want to spend a whole lot of taxpayers' money to do it. We can't do it all.

Inherent, we think, in this do-nothing approach is, when the market starts speaking for itself and the system starts acting for itself, that there are going to be some foreclosures. There will be some restructuring that can be worked out, too. I think what is clear is the fact, no bank within the system or even a private lender is going to foreclose on nothing. I mean, there has got to be something reasonable for them to think that they can get out of it, and so they will be more encouraged to restructure if they are not going to get anything out of it at all. But by doing nothing, it is going to force the system to concentrate on salvaging what the market says is going to be salvageable.

Mr. STENHOLM. I don't guess there is any doubt in most of our minds that a lot of that is going to occur; that it is physically impossible to bail out every farmer, every banker, every PCA. You are going to see some tremendous losses.

Mr. BREDEMEIER. I think so.

Mr. STENHOLM. I guess my concern is the idea that we can take a $75 billion bank and let it go, when the same thought processes apparently were, on Continental Illinois, which was a $45 billion bank, and it seemed that it was the judgment of Mr. Volker—of all people—that we could not afford to let that happen with that bank, yet you seem to be saying that we can afford to do it here, and——

Mr. BREDEMEIER. I think you would have heard similar testimony from me if I was here for First Continental, because I don't think the macroeconomic effects were as severe for First Continental, certainly not on the economywide scale. It may have been more of a problem in the banking industry itself, but then you're dealing with a different group of interests. So I don't agree with the approach taken on First Continental.

You know, it's a tough thing to sit here and say, "Do nothing and see what happens," but the analyses here show that something can be done. I would reiterate what I said before, that the proposal pending, that the question before the House, the $5 billion line of credit, still isn't going to do what we want it to do. It is not going to do anything on repayment, and there is no guarantee. I think it's clear, the Governor made clear yesterday and other officials have made clear, that they can't say they are not going to be back here next year, and the private banking industry is going to be back here next year, too; $5 billion just isn't enough, even if the money was going to where it should go, and a revolving line of credit, it is not going to go anywhere but within the system.

Mr. **Stenholm**. You speak an alarming amount of truth.

Mr. **Bredemeier**. Excuse me?

Mr. **Stenholm**. I said you speak an alarming amount of truth.

Mr. **Bredemeier**. Thank you, sir.

Mr. **Jones** of Tennessee. Mr. Evans, do you have anything else?

Mr. **Evans** of Iowa. No questions.

Mr. **Jones** of Tennessee. Thank you very much, gentlemen.

Before I dismiss the panel now, and before the crowd that is left starts stirring, let me say to the subcommittee members that are here, and I have talked to some of the others and I have talked to the chairman, that we are going to try to get together tomorrow for a brief meeting to discuss these 2 days of hearings and to see where we go from here.

Mr. **Stenholm**. What time?

Mr. **Jones** of Tennessee. No time has been set, Charlie, because we've got a meeting with the Secretary at 8 o'clock in the morning, and I think the Democratic Caucus meeting or somebody is meeting at 9 o'clock. I'm not sure. We'll just have to get a calendar and watch tomorrow and figure it out, and we'll just have to notify everybody, but I think we are going to be in session so we can work it out some way.

I thank everybody for the time and for your willingness to remain here this long. The subcommittee does stand adjourned at the call of the Chair.

[Whereupon, at 5:35 p.m., the subcommittee recessed, to reconvene at the call of the Chair.]

[Material submitted for inclusion in the record follows:]

STATEMENT OF
THE HONORABLE TERRY E. BRANSTAD
GOVERNOR OF IOWA

MR. CHAIRMAN, MEMBERS OF THE SUBCOMMITTEE, THANK YOU FOR THIS OPPORTUNITY TO VISIT WITH YOU TODAY ABOUT THE FARM CREDIT CRISIS IN AMERICA. I WOULD LIKE TO COMMEND THE SUBCOMMITTEE FOR HOLDING THESE HEARINGS ON THIS CRITICAL PROBLEM.

MY MESSAGE TODAY IS SIMPLE AND CLEAR: OUR NATION'S FARM CREDIT SYSTEM IS BEING SUCKED INTO A FINANCIAL WHIRLPOOL. WE MUST TAKE ACTION NOW TO PREVENT OUR NATION'S FOOD PRODUCERS FROM DROWNING. I BELIEVE IT IS IMPERATIVE FOR THE ADMINISTRATION AND FOR CONGRESS TO WORK TOGETHER ON A FARM CREDIT PACKAGE WHICH WILL RESTORE STABILITY TO AGRICULTURE BEFORE YOU GO HOME FOR YOUR CHRISTMAS RECESS. IF YOU FAIL TO RESPOND TO THIS CHALLENGE, THOUSANDS OF FARMERS THROUGHOUT OUR COUNTRY WILL BE FORCED OFF THEIR LAND IN A WINTER OF DISCONTENT; AND OUR NATION'S FARM CREDIT SYSTEM AND, INDEED, OUR ENTIRE FINANCIAL STRUCTURE WILL BE PUT IN JEOPARDY.

I KNOW THESE ARE STRONG WORDS AND THAT THERE ARE MANY WHO WISH THAT THE PROBLEM WOULD SIMPLY GO AWAY. BUT STRONG WORDS ARE NEEDED TO REFLECT THE GRIM REALITY FACING OUR NATION'S HEARTLAND TODAY. THE PROBLEM WILL NOT GO AWAY DESPITE THE FERVENT WISHES OF SOME BANKERS ON WALL STREET AND SOME OFFICIALS IN WASHINGTON.

FOR OVER A YEAR AND A HALF NOW, I HAVE BEEN SOUNDING THE CALL TO TAKE ACTION TO DEAL WITH OUR NATION'S FARM CREDIT CRISIS. WHILE SOME TENTATIVE STEPS WERE TAKEN LAST WINTER TO PROVIDE GUARANTEES FOR FARM OPERATING LOANS, NO SIGNIFICANT ACTION HAS BEEN TAKEN TO DEAL WITH THE CORE OF THE PROBLEM -- A DRAMATIC DECLINE IN OUR NATION'S LAND VALUES WHICH HAS SUCKED THE WEALTH AND LIFE OUT OF RURAL AMERICA. FOR OVER A YEAR AND A HALF WE IN THE HEARTLAND OF THIS COUNTRY HAVE WARNED YOU IN WASHINGTON THAT THE FINANCIAL SICKNESS IN RURAL AMERICA WOULD SPREAD TO THE URBAN STREETS OF THIS COUNTRY. DESPITE OUR WARNINGS, SIGNIFICANT ACTION HAS NOT YET BEEN TAKEN.

TODAY I AM HERE TO WARN YOU THAT YOU CAN NO LONGER DELAY: IF YOU DO NOT TAKE ACTION THIS YEAR TO STOP THE HEMORRHAGING IN OUR NATION'S FARM FINANCIAL SYSTEM, NONE OF YOU WILL BE SPARED THE EFFECTS OF THE BLEEDING.

I KNOW THAT YESTERDAY YOU HAD THE OPPORTUNITY TO VISIT WITH THE OFFICIALS IN THE FARM CREDIT SYSTEM ABOUT THEIR PERCEPTIONS OF THIS PROBLEM. AND, I AM SURE THAT YOU HAVE RECEIVED OTHER DOCUMENTATION OF THE GRAVITY OF THE PROBLEM THAT FACES US.

HOWEVER, LET ME OUTLINE FOR YOU AT LEAST TWO REASONS WHY IMMEDIATE ACTION IS NEEDED TO DEAL WITH OUR FARM CREDIT CRISIS.

1. THE PROBLEM IS GETTING WORSE. LAST JANUARY, WHEN I VISITED KEY CONGRESSIONAL AND ADMINISTRATION LEADERS, I INDICATED THAT BETWEEN 30 AND 40 PERCENT OF OUR NATION'S FARM DEBT WAS IN TROUBLE. TODAY, A STUDY SOON TO BE RELEASED BY IOWA STATE UNIVERSITY, INDICATES THAT 73 PERCENT OF THE FARM DEBT HELD BY OUR COMMERCIAL BANKS HAS A DEBT TO ASSET RATIO OF 40 PERCENT AND ABOVE. EIGHTY-ONE PERCENT OF THE DEBT HELD BY PCAs AND 75 PERCENT OF THE DEBT HELD BY OUR FEDERAL LAND BANKS ARE ON THE CRITICAL LIST. AND, UNFORTUNATELY, THE PROBLEM WILL PROBABLY GROW WORSE BEFORE IT GETS BETTER. THESE SAME IOWA STATE UNIVERSITY EXPERTS HAVE INDICATED THAT LAND VALUES HAVE PROBABLY DROPPED AN ADDITIONAL 15 TO 20 PERCENT THIS YEAR IN IOWA, ON TOP OF THE 40 TO 50 PERCENT DECLINES WE HAD EXPERIENCED OVER THE PAST FOUR YEARS.

MOREOVER, A SOON TO BE RELEASED STUDY BY THE ECONOMIC INDICATORS BRANCH OF THE USDA WILL SHOW THAT 60 PERCENT OF THE DEBT HELD BY THE FARM CREDIT ADMINISTRATION IN THIS COUNTRY WAS HELD BY FARMERS WHO WERE NOT CASHFLOWING IN 1984.

THESE DRAMATIC FIGURES CANNOT HELP BUT HAVE A DEVASTATING IMPACT ON THE FARM CREDIT SYSTEM AND OUR NATION'S ENTIRE BANKING STRUCTURE.

IT HAS BEEN INDICATED TO ME BY OFFICIALS WITHIN THE FARM CREDIT ADMINISTRATION THAT, AFTER NECESSARY LOSS RESERVES ARE TAKEN INTO ACCOUNT, A $1.5 BILLION LOSS IS EXPECTED BY THE FARM CREDIT SYSTEM DURING 1985. AND THE LOSS IN 1986 IS LIKELY TO BE EVEN LARGER. IF ACTION IS NOT TAKEN SOON BY THE FEDERAL GOVERNMENT TO STABILIZE THE FARM CREDIT SYSTEM, IT IS EXPECTED THAT 40 PCAS, THREE FICBS AND TWO LAND BANKS WILL BE LIQUIDATED. AND THOUSANDS OF FARMERS WILL BE FORCED FROM THEIR HOMES AND FROM THEIR LAND.

IN ADDITION, INTEREST RATES FOR THE REMAINING FARMERS WILL RISE IN ORDER TO ABSORB THESE LOAN LOSSES; THERE WILL BE FAR MORE FARM FORECLOSURES THAN WE HAVE WITNESSED TO DATE, AND FRANKLY, BY THIS TIME NEXT YEAR, THE FARM CREDIT SYSTEM WILL PROBABLY BE OUT OF BUSINESS.

I KNOW THAT SOME BELIEVE WE SHOULD BLEED THE FARM CREDIT SYSTEM DRY BEFORE WE PROVIDE IT WITH A TRANSFUSION. I SHARE THE DESIRE TO MAKE THE FARM CREDIT SYSTEM USE ITS AVAILABLE RESERVES. BUT, I RESPECTFULLY REQUEST THAT YOU CONSIDER THE FACT THAT IF WE ALLOW THE FARM CREDIT SYSTEM TO GO DRY, THERE WILL BE FEW AVAILABLE FUNDS NEXT SPRING TO PUT A CROP IN THE GROUND. AND, THE COSTS OF THE INEVITABLE FEDERAL BAIL-OUT ONCE THOSE RESERVES ARE TOTALLY DRIED UP WILL BE MANY TIMES WHAT IT IS TODAY.

AND ALLOWING A SYSTEM THREE TIMES THE SIZE OF THE CONTINENTAL ILLINOIS BANK TO GO BELLY-UP WILL SEND SERIOUS SHOCKWAVES THROUGH OUR NATION'S ENTIRE FINANCIAL STRUCTURE.

IN SHORT, THE NEED FOR FEDERAL INTERVENTION IS GROWING EVERY DAY. MANY MORE FARMERS THAN EVER BEFORE ARE IN SERIOUS TROUBLE, THE FARM FINANCIAL INSTITUTIONS THEMSELVES ARE ON THE VERGE OF COLLAPSE, AND OUR NATION'S FINANCIAL STABILITY DEMANDS ACTION NOW.

2. I ALSO SUBMIT TO YOU THAT THE TIMING OF YOUR ACTION THIS YEAR COULD PROVIDE REAL HOPE TO OUR NATION'S HEARTLAND. I BELIEVE THAT APPROPRIATE FEDERAL ACTION THIS YEAR WOULD RESULT VERY QUICKLY IN A STABILIZATION OF LAND VALUES. IN COMBINATION WITH A FARM BILL WHICH PROVIDES INCOME PROTECTION, WE COULD ACTUALLY SEE SOME IMPROVEMENT IN OUR NATION'S AGRICULTURAL FINANCIAL SYSTEM NEXT YEAR. WE NEED HOPE IN THE HEARTLAND; DESPAIR REIGNS THERE NOW. APPROPRIATE ACTION BY CONGRESS THIS YEAR WILL PROVIDE A REAL FINANCIAL AND PSYCHOLOGICAL BOOST WHICH IS DESPARATELY NEEDED.

I KNOW THAT ACTION IN CONGRESS HAS BEEN STYMIED TO DATE BECAUSE OF THE LACK OF CONSENSUS ON APPROPRIATE ACTION. BUT, I DON'T BELIEVE THAT SHOULD BE THE CASE FOR LONG.

LET ME OUTLINE FOR YOU THE PRINCIPLES WHICH SHOULD GUIDE YOUR ACTIONS. THESE PRINCIPLES HAVE BEEN AGREED ON BY THE NATIONAL GOVERNORS' ASSOCIATION SUBCOMMITTEE ON FEDERAL AGRICULTURAL FINANCIAL ASSISTANCE. THIS BIPARTISAN GROUP OF GOVERNORS BELIEVES THAT THESE PRINCIPLES CAN PROVIDE YOU WITH A ROAD MAP FOR IMMEDIATE ACTION.

FIRST, THE FOCUS OF FEDERAL ASSISTANCE SHOULD BE ON BENEFITING FARMERS AND THEIR FAMILIES AS WELL AS THE CREDIT SYSTEMS. WE DO NOT WANT THE NET RESULT OF FEDERAL ASSISTANCE TO BE THE WIDESPREAD LOSS OF PRIVATE OWNERSHIP OF FARM LAND, THE DISLOCATION OF FARM FAMILIES, AND SUBSTANTIAL INCREASES IN TENANT FARMING. WE WANT TO KEEP OUR FARM FAMILIES ON THEIR FARMS AND MAINTAIN THE BEST FOOD PRODUCTION SYSTEM IN THE WORLD. IF WE DO THAT, WE WILL ALSO SAVE OUR LOCAL BUSINESSES, SCHOOL DISTRICTS, RURAL POLICE AND FIRE PROTECTION, RURAL ELECTRIC AND OTHER COOPERATIVES, AND LOCAL GOVERMENT TAX BASE.

THEREFORE, THE NATION'S GOVERNORS BELIEVE THAT ANY ASSISTANCE SHOULD BE SPECIFICALLY TARGETED TO THE PRESERVATION OF EXISTING FARMS. IT WOULD BE AN EXTREMELY COSTLY, EVEN WASTED, VENTURE TO STABILIZE RURAL LENDERS IF THE FARMERS ARE NOT MADE SUBSTANTIALLY STABLE.

LAST SUMMER, I OUTLINED SEVERAL IDEAS TO STABILIZE AND IMPROVE THE FARM CREDIT SYSTEM. I AM PLEASED TO REPRESENT THE NATION'S GOVERNORS WHO HAVE INDICATED THAT THE FARM CREDIT CRISIS NEEDS TO BE ADDRESSED WITH:

A. AN INTEREST RATE BUY-DOWN TO ALLOW ELIGIBLE FARMERS TO ACHIEVE ECONOMIC STABILITY.

B. A MECHANISM TO STRUCTURE REAL ESTATE LOANS TO FAMILY FARMS TO AVOID FURTHER EROSION OF FARM REAL ESTATE VALUES. THE GOVERNORS BELIEVE THAT WE SHOULD KEEP FARMERS ON THE LAND AND THE TITLE TO THE LAND SHOULD STAY WITH THE FARMER WHEREVER POSSIBLE. FARMERS NEED TO HAVE A REASONABLE OPPORTUNITY TO WORK THEIR DEBT LOAD DOWN TO THE POINT WHERE THEY WILL BE ABLE TO SURVIVE.

C. AN APPROPRIATE POLICY OF FOREBEARANCE IN LIEU OF FORECLOSURE AND REPOSSESSION. A POLICY OF LEASE BACK TO FARMERS WHO HAVE BEEN FORECLOSED UPON SHOULD ALSO BE CONSIDERED TO HELP STABILIZE RURAL AMERICA AND TO AVOID FURTHER DETERIORATION OF LAND VALUES.

3. THE FARM CREDIT CRISIS IS MUCH LARGER THAN JUST THE FARM CREDIT SYSTEM. A PROGRAM TO ASSIST ONLY THE FCS WOULD BE SHORT-SIGHTED AND FALL FAR SHORT OF THE ASSISTANCE NEEDED TO ENHANCE THE AG ECONOMY.

4. THE NATION'S GOVERNORS AGREE THAT WE NEED TO PROVIDE PUBLIC INPUT INTO POLICY DEVELOPMENT. CONGRESS SHOULD REQUIRE THAT THE FARM CREDIT SYSTEM BANK HOLD HEARINGS AND ALLOW PUBLIC COMMENT BEFORE POLICY CHANGES ARE MADE.

MOREOVER, WE ARE CONCERNED THAT THE FARM CREDIT SYSTEM, IN ITS PUBLIC EFFORT TO SEEK FEDERAL ASSISTANCE, HAS BEEN VAGUE AS TO THE MANNER IN WHICH FEDERAL MONIES WOULD BENEFIT ITS FARM MEMBERS AND STOCKHOLDERS. EXPERIENCE HAS TAUGHT US THAT THE FARM CREDIT SYSTEM DIRECTORS DO NOT ALWAYS PROVIDE ACCURATE AND TIMELY INFORMATION. FOR EXAMPLE, I WARNED FCA OFFICIALS EARLIER THIS YEAR THAT THE SYSTEM WAS HEADED FOR REAL TROUBLE. BUT, MY WARNINGS WERE MET WITH AN ATTACK ON MY CREDIBILITY. FINALLY, THREE MONTHS LATER THEY ADMITTED THEY ARE IN REAL TROUBLE. EVEN TODAY, I SUSPECT THAT THEY DO NOT KNOW THE FULL EXTENT OF THE PROBLEMS FACING THE SYSTEM.

I BELIEVE THE FARM CREDIT SYSTEM NEEDS TO BE RESTRUCTURED TO PREVENT THE PRESENT FINANCIAL CATASTROPHE FROM HAPPENING AGAIN. IN THE SHORT RUN, IT IS MY OPINION THAT FEDERAL ACTION TO PROVIDE FINANCIAL ASSISTANCE TO THE SYSTEM MUST ALSO INCLUDE A REFORM OF THAT SYSTEM. THIS REFORM SHOULD INCLUDE THE FOLLOWING:

1. REQUIRE MORE REAL MONEY RESERVES TO BACK LOANS THAT ARE MADE INSTEAD OF ALLOWING THE SYSTEM TO HOLD THE PAPER RESERVES;

2. REQUIRE A THIRD PARTY AUDIT OF THE SYSTEM;

3. ESTABLISH AN INSURANCE SYSTEM SIMILAR TO THE FDIC WITHIN THE FARM CREDIT SYSTEM TO PROVIDE A SAFETY NET BENEATH THE BONDS;

4. PROVIDE A WAY FOR THE SYSTEM TO LIVE WITH THE LACK OF DIVERSITY IN ITS PORTFOLIO BY POSSIBLY ESTABLISHING AN INDEMNITY FUND.

THESE ACTIONS MUST BE TAKEN TO AVOID A FUTURE FARM CREDIT CATASTROPHE.

AT THE SAME TIME, I BELIEVE THAT WE NEED TO MAINTAIN THE ABILITY TO EXERCISE APPROPRIATE LOCAL CONTROL OVER DECISIONS WITHIN THE FARM CREDIT SYSTEM. CERTAINLY, WHILE SOME FINANCIAL MANAGEMENT SHOULD BE DONE ON A NATIONAL LEVEL, THERE IS NO REASON TO ELIMINATE THE FARMER-OWNED AND FARMER-CONTROLLED SYSTEM.

IN ADDITION, IN THE LONG RUN, CONGRESS SHOULD ADDRESS THE VERY SERIOUS NEED TO PROVIDE A SOURCE OF LONG TERM REAL ESTATE CREDIT TO OUR AGRICULTURAL SYSTEM. YOU MAY WISH TO CONSIDER THE ESTABLISHMENT OF A SECONDARY MARKET FOR FARM REAL ESTATE MORTGAGES TO ASSURE THE AVAILABILITY OF REAL ESTATE CREDIT IN RURAL AMERICA AS WELL AS TO PROVIDE THE ABILITY OF OTHER FINANCIAL INSTITUTIONS TO PARTICIPATE IN THIS MARKET.

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AS MANY OF YOU KNOW I RECENTLY TOOK EXTRAORDINARY ACTION BY IMPOSING A LIMITED FARM MORTGAGE FORECLOSURE MORATORIUM. THIS STEP WAS UNPRECENTED IN MODERN TIMES; IT WAS A STEP THAT WAS QUESTIONED BY SOME. BUT I WANT YOU TO KNOW THAT I TOOK THIS ACTION BECAUSE I SEE A CRITICAL NEED TO BUY SOME ADDITIONAL TIME FOR MANY OF OUR FARMERS. I ALSO WANTED TO SEND A SIGNAL TO YOU, THE DECISION-MAKERS IN WASHINGTON, THAT WE NEED HELP IN THE HEARTLAND.

I ASK YOU TO HEED MY WARNING AND TO TURN THE DESPAIR IN THE HEARTLAND INTO HOPE. WE NEED ACTION AND WE NEED IT THIS YEAR.

THANK YOU.

OCT 31 1985

Summary of the Administration's Position on the Farm Credit System

The Administration is in the process of an intensive Administration-wide review of the operating conditions, strengths and weaknesses of the operating Farm Credit System. As part of this review, extensive discussions have been conducted with representatives of the operating system, their independent accountants Price Waterhouse, and the Governor and the senior staff of the Farm Credit Administration.

While the issues and problems faced by the Farm Credit System are unusually complex and varied, it is the Administration's view that the system's projections of the necessity of reporting substantial losses during the next two years in the magnitude of $2.5 billion from the fourth quarter of the current year and $1-1/2 billion for each of the next two years is based on reasonably prudent economic assumptions. Based on the assumption made by the operating system and its accountants, the system, after taking the appropriate steps to reserve and manage its problem loans, should return to a positive operating position in 1988.

The operating system, including its associations, continues to have a very strong financial balance sheet. As of September 30, it has loan loss reserves totaling some $1.6 billion, earned net worth of $5.5 billion and member stock totaling $5.3 billion. This $12.4 billion in funds, coupled with a high percentage of loans which continue to perform adequately, provides the capacity and the potential in our view for the system to be able to effectively work in its own behalf to remain an effective and viable lender if provided with the necessary tools to do so.

Therefore, the Administration proposes:

First, creating authority for an internal Farm Credit System entity that would mobilize the system's earned surplus in order to absorb operating losses and manage troubled loan assets.

Second, restructuring the Farm Credit Administration into a true arm's length financial regulator whose authorities would include matters of entry and exit, capital, safety and soundness, and enforcement of supervisory directives.

If Congress is willing to legislate both (1) the self-help changes that will enable FCS to tap its own considerable resources, and (2) the reform of FCA into an independent supervisor, the Administration will assess the need for Federal financial assistance.

We believe the best mechanism for handling the System's bad asset problem is to permit the Farm Credit System's Capital Corporation (FCSCC), established under the FCS, to:

a) acquire from financially troubled System institutions loans and property at no greater than market value;

b) assume or issue obligations, that would be jointly and severally guaranteed by the FCS, so as to carry the assets while they are being held, leased, or restructured in an orderly fashion;

c) obtain earned surplus from those operating units which have it and transfer it to those which are in deficit; and

d) assess the operating units to capture sufficient future earnings as support for FCSCC's debt service obligations and operating losses, subject to existing FCA regulations to transfer capital.

We believe the best mechanism for ensuring a permanent solution to the System's operating problem is to provide a strong and effective financial regulatory agency with authority broadly similar to that regulating nonfarm financial institutions.

The reformed regulatory authority should be provided with general powers that include:

a) restructuring of present management board with a single Chairman appointed by the President and confirmed by the Senate;

b) general rulemaking authority and examination and enforcement powers;

c) power over exit and entry to the system, including approval and/or requiring mergers; and

d) authority to establish capital requirements and safety and soundness provisions.

The Administration is convinced that the actions I have just outlined will assure a steady supply of available credit for farmers and ranchers at reasonable rates. Further, these actions will help stabilize declining land values by assuring that precipitous liquidation of land loans can be avoided. This stability in rural credit markets will assist all farm borrowers, even those who are not participants in the Farm Credit System.

In addition, it should be remembered that FmHA loan guarantees are available to qualified farm credit borrowers and that most farm credit associations are FmHA approved lenders.

TESTIMONY OF CONGRESSMAN BILL ALEXANDER OF ARKANSAS BEFORE THE HOUSE AGRICULTURE SUBCOMMITTEE ON CONSERVATION, CREDIT AND RURAL DEVELOPMENT

Mr. Chairman, I want to thank you and the members of the Subcommittee for giving me the opportunity to testify before you today.

Without exaggeration, American farmers face the worst crisis since the Great Depression. Figures on the farmers' financial plight are startling. Of the Nation's 2.2 million farm operations:

-- 98,000 are technically insolvent;

-- 109,000 have extreme financial problems and are repidly moving towards insolvency; and

-- 417,000 have financial problems so severe that they may require some form of debt or asset restructuring assistance in order to help them survive.

We all know the root cause of the problem we are dealing with today -- the record low prices our farmers are receiving for their crops. Government policies have created an overvalued dollar, made U.S. farm products too expensive overseas and created crushing surpluses that have depressed farm prices. Farmers simply are not earning enough to pay back their loans.

The farm credit system is hurting because our farmers are in distress. You and I know that any aid to the credit system will necessarily be stop-gap until the farmer is given a fair price for his crop and earns enough to pay off his debts.

There are three basic components to the credit system available to farmers: private lending, the Farm Credit System, and the Farmers Home Administration (FmHA).

In Arkansas, we have approximately 55,000 farmers. FmHA lends to 13,000 of them -- about 23% of the state's farmers. In the first district of Arkansas, which I have represented for 17 years, the delinquency rate on FmHA loans is over 50%. The state's delinquency rate has nearly tripled since 1979, up from 12% to 35%.

Nationally, the Farm Credit System is suffering its first loss in decades. In Arkansas, the Farm Credit System has been trying to cut its exposure and reduce risk to the system. FCS granted 10,000 loans this year in Arkansas, down from the 10,560 granted in 1984. Even with that cutback, delinquencies are up 20% this year over last year: 571 delinquent loans in 1985 compared to 476 delinquent loans in 1984.

Another way to measure the stress on the FCS in Arkansas is to look at the number of properties the system has acquired in the past two years as a result of bankruptcy, foreclosure or voluntary conveyance. In 1984, the FCS acquired 15 properties -- a total of 6,800 acres valued at $6.2 million. This year, the number of acquired properties has risen to 42 -- or a total of 21,400 acres valued at $13.8 million. That is a 180% jump in one short year!

Non-accrual FCS loans, that is loans still on the books but lacking sufficient collateral to avoid loss, are skyrocketing in Arkansas. Non-accurals in 1984 were valued at $17.8 million. This year, the figure is $55.3 million, a 211% increase.

As we look ahead, there appears to be no light at the end of the tunnel.

The final component of the credit system available to the farmer is the private lending system -- the commercial bank.

One commercial bank in five in Arkansas is now operating under some form of administrative order. Arkansas State Banking Commissioner, Marlin Jackson, declared two weeks ago that the state's banks have become hostage to agrargian economies and warned of a crisis in the banking industry in three to five years if nothing is done.

He pointed to a 1,150% increase in the number of Arkansas banks on the FDIC problem bank list. In 1980, he said, four state banks were listed. By November of this year, 50 Arkansas banks will be on the list.

The figures I have just cited speak loudly and clearly. They shout that the farm credit situation in Arkansas has reached crisis proportions. This situation can only worsen. As more farmers are forced off of the land, more land will be put up for sale. Land values will be depressed even further for those other farmers still struggling to keep their heads above water.

Immediate action is critical to help shore up the Farm Credit System. As we undertake this effort, we must protect the person the system was designed to help -- the family farmer.

Each of the three components of the credit system -- FmHA, FCS and the commercial lender -- must ultimately be addressed by Congress. Measures to aid any one part will be helpful but run the risk of being undercut if the other two legs of the system collapse.

Federal aid should include reduced-interest loans for farmers, a program for restructuring farm debt, and a policy of forebearance with farmers who are in default.

In certain situations, I propose that Congress exempt a farmer's homestead from foreclosure. Foreclosure relief on a farmer's home would leave the farmer with at least some part of his dignity intact. It is no value to this country to force the farmer off of his homestead without a place to live or a job to go to. Farmers are being displaced through no fault of their own.

We must remember that many of our farmers are not in a position to easily shift occupations. National statistics show that the age of the average farmer to be over 50. He is isolated from access to other kinds of work by geography and training. When his farm goes, so too does his whole livelihood.

Statistics developed in Missouri show the human toll of the farm crisis. Rural sociologists rank the farmer as having the highest suicide rate of any occupation in that state. According to Dr. Bill Heffernan of the University of Missouri at Columbia, 71 farmers committed suicide in Missouri last year, a 160% increase in the past two years.

This Subcommittee will be hearing a host of solutions to the present FCS crisis. Let me reiterate my hope that you will not lose sight of the small family farmer, and that your approach will address the whole farm credit system.

Of all of the ideas I have heard, the Farm Credit Council's Agriculture Conservation Corporation makes the most sense. As I understand it, a holding company would be established for bad debts. This holding company would be open to all three parts of the farm credit system. Creation of the ACC would stabilize farm assets. It would provide many farmes with an opportunity to restructure their assets and therefore give them a greater chance at surviving and once again thriving. Moreover, it would provide a mechanism for conservation of fragile land resources.

Again, let me thank the Chairman and the Subcommittee for the opportunity to testify.

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STATEMENT OF HUBERT H. HUMPHREY, III
ATTORNEY GENERAL OF THE STATE OF MINNESOTA
TO
UNITED STATES HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON CONSERVATION, CREDIT AND RURAL DEVELOPMENT

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

I. INTRODUCTION

My name is Hubert H. Humphrey, III. I am the Attorney General of the State of Minnesota. I am pleased to speak to you today about issues which are of great importance to the farmers of Minnesota and the nation.

I am here today first as an independently-elected state official from Minnesota. Because Minnesota is a largely agricultural state, my constituency is directly affected by the serious difficulties in today's agricultural economy. Second, I am here as one of several midwestern attorneys general concerned with Farm Credit System practices. As you know, last month, 11 midwestern attorneys general wrote Farm Credit Administration Governor Wilkinson to tell him about the specific problems which our constituents are experiencing with the Farm Credit System. Finally, I am the chairman of the Agriculture and Rural Legal Affairs Committee of the National Association of Attorneys General.

II. LETTER TO THE FARM CREDIT ADMINISTRATION

Our letter to Governor Wilkinson urged him to reinstate fundamental elements of fairness in Farm Credit System lending practices. Of the group of 11 participating attorneys general, Attorney General Tom Miller and I are here today to discuss this issue with you.

All of the attorneys general have received increasing numbers of complaints regarding a variety of Farm Credit System practices. The letter outlines these comlaints in five major categories: disclosure of loan terms, access to documents and information, fairness and right of review of loan decisions, forebearance and shareholder rights. It is our position that any financial assistance package provided for the Farm Credit System must be coupled with a requirement that the System implement whatever reforms are necessary to address these complaints. I appreciate this opportunity today to describe these issues for you and to illustrate, using examples received by my office, the impact which many current Farm Credit System practices are having on the nation's farmers.

III. ACCESS TO INFORMATION

One of the most common complaints received by my office concerns the inability of Farm Credit System borrowers to obtain copies of documents which should readily be available to them. For example, a farmer in Glencoe, Minnesota, asked her Federal Land Bank if she could see her file because she wished to begin negotiating some kind of loan servicing. She was told by the loan officer that she could not see any of the information in her file. It was not until a member of my staff contacted the bank that she was provided with even the most basic information from her file. Even after my office's call, she was still only permitted to see those documents which she had signed.

Similarly, a farmer from Lake Benton, Minnesota, wrote his Federal Land Bank requesting a copy of the bank's by-laws. The bank refused to send him a copy. Again, it was only after intervention by my office that the bank provided the material requested.

It is fundamental that a borrower should have access to relevant documents governing his loan and that a shareholder should have access to germane corporate documents. Although the Farm Credit Administration has recently recognized in proposed regulations that at least some of this information should be accessible, it must take steps to assure that its member institutions make readily available to borrowers and shareholders all appropriate information.

In addition, I support regular, thorough audits of local and regional entities within the Farm Credit System by the General Accounting Office or some other agency which Congress may appoint. Recent developments in the Seventh District underscore the need for such scrutiny. Like the parent System, the Seventh District last week announced a third quarter loss which substantially exceeded that predicted. However, the indications of fiscal difficulties began to appear earlier. On May 14 of this year, the Federal Lank Banks in the Seventh District announced that they were increasing their variable loan interest rate by 3/4 per cent effective June 1. For most farmers, this increase has not been reversed. The reason given by the Land Banks for the increase was an increase in their own cost of money. Yet at the time of the 3/4 per cent increase, other interest rates were steadily declining. The 6-month Treasury bill rate rose in the first quarter but fell from 9.04 in March to 7.08 in July. The prime rate fell steadily from 10.75 in January to 9.50 in July. These circumstances demonstrate that there is a serious question about the true financial status of individual member institutions as well as the Farm Credit System as a whole. Objective, accurate, meaningful and public reporting on these entities is essential to addressing the financial difficulties within the Farm Credit System.

IV. FAIRNESS AND RIGHT OF REVIEW

The second issue which I will address is that of fundamental fairness for the Farm Credit System borrower. There are two principal facets to this issue. The first is the need for the Farm Credit System to give its borrowers ample notice of adverse credit decisions and a right of review of those decisions. The second is the need for the System to adhere to the letter and spirit of its own regulations.

Fundamental fairness requires that a borrower be given sufficient notice of a potential change in his status to remedy the problem. It also requires that the borrower be provided with meaningful review--by someone other than the original decision-maker--of any adverse credit decision.

Neither of these elements is presently a regular part of Farm Credit System practices. For example, a farmer from Dakota County, Minnesota, had a solid payment record with his Production

Credit Association for 15 years. Last year he became one month delinquent, and received an acceleration notice from the PCA. The notice stated that he had 15 days to pay on his note. However, he received the notice only 3 days before the 15 day period expired. Surely this is a prime example of woefully inadequate notice. Fortunately, the farmer was able to negotiate a settlement with the PCA which extended the time allowed for repayment, and he promptly brought his payments up to date. Unfortunately, simultaneously with the acceleration notice, the PCA also told the farmer that his interest rate would be increased by 2.8 per cent because he was now considered a "problem" borrower.

The farmer brought his loan up to date and paid the increased amounts through September of this year. He then requested that the PCA review his situation and lower his interest rate to its prior level. The bank refused, telling the farmer that his classification as a problem borrower was indefinite and not reviewable.

Similarly, a farmer from Kandiyohi County, Minnesota, was recently informed that his Production Credit Association had devalued his collateral and classified his loan as uncollectible. This farmer has been with the PCA for 29 years and always has been up-to-date on his payments. His crop was devalued not because he was delinquent but because he did not have all-peril insurance. However, the farmer had never been informed that all-peril insurance was necessary. He had always been told that hail insurance, which he has, was sufficient. Now because it is too late for him to get all peril insurance, he is not able to obtain additional credit from the PCA for harvest. Again, the farmer was told that the lender's decision was not reviewable.

These stories illustrate the need for the fundamental elements of notice and hearing in the Farm Credit System. These elements are basic to our notions of fair play. In addition, the effect in these situations, as in many others, is to potentially squeeze out the farmer who is still making it today, but who may be forced out unnecessarily if he is not given some objectively reasonable opportunities to continue on. This result is inconsistent with the purpose of the Farm Credit Act and is not in the public interest.

In addition, the Farm Credit System must take care to abide by its own regulations. An issue of particular concern in this regard is the apparent failure of System lenders to adhere to current regulations and establish appropriate standards regarding the appraisal of land value. While the regulations establish principles of appraisal, the lenders have instead adopted a policy of using "benchmark farms" to value real estate for an entire state. For example, Minnesota has over 94,000 farms and 87 counties. However, Farm Credit Services in St. Paul uses only 33 benchmark farms in 28 counties to appraise Land Bank security in the state. It must be seriously questioned whether these benchmark farms are sufficient to assess land values in Minnesota where over half of the farm real estate debt is held by the Farm Credit System. This issue is particularly important today when numerous System borrowers are being declared in default, not because they are delinquent in their loan payments, but because their collateral is being rapidly and drastically devalued.

VI. FOREBEARANCE

Finally, I would like to comment on the issue of forebearance. I recognize that the Farm Credit Administration has a general statement regarding forebearance in its regulations. I also recognize that Farm Credit System lenders do from time to time make forebearance available to troubled borrowers. However, the System's practice in this area is completely ad hoc. For example, a Production Credit Association in Minnesota provided the down payment for a farmer buying property on a contract for deed. A Minnesota Department of Agriculture program provided the PCA with a 90 percent guarantee on the loan. The farmer kept up his payments, and when it was time for him to seek an operating loan, he went to the PCA. The PCA responded by reevaluating the farmer's property, excluding its value with the guarantee. The PCA then gave the farmer an ultimatum: he would receive no operating money unless he would give up his farm and rent.

This example illustrates two aspects of forebearance which the Farm Credit System must implement. First, before handing a borrower an ultimatum, the System should provide him with some opportunity to work out his particular difficulty. Second, the

System should cooperate with other lenders to help borrowers work out those difficulties. In this example, the PCA made no effort whatsoever to contact the Minnesota Department of Agriculture to work out any kind of arrangement. As a result, the farmer has lost his farm. In addition, the PCA is now being sued by the Minnesota Department of Agriculture for certain violations of the guarantee agreement. The practice of forebearance here would have benefitted all three participants: the farmer, the PCA, and the State of Minnesota.

VII. CONCLUSION

I hope that these comments will be of use to you in your deliberations. I urge that any financial assistance package which is provided to the Farm Credit System be coupled with statutory requirements that will assure consistent fairness in the System's dealings with its borrowers and shareholders. Such a mandate will fulfill Congress' objectives in enacting the Farm Credit Act. It will also help return agriculture to a healthy, productive condition.

(Attachments follow:)

DRAFT

PROPOSED AMENDMENTS TO THE FARM CREDIT ACT

I. DISCLOSURE OF LOAN TERMS

A new provision (adapted from the Truth In Lending Act, 15 U.S.C. §§ 1601-1667c, and Regulation Z, 12 C.F.R. part 226):

A. General Disclosure Requirements

1. Content of disclosure. For all proposed loan agreements, Farm Credit System institutions shall disclose the following information as applicable:

a. Annual percentage rate. This rate is a measure of the cost of credit, expressed as a yearly rate, that relates the amount and timing of value received by the consumer to the amount and timing of payments made. (Note: this definition is taken from Regulation Z, 12 C.F.R. § 26.22.)

b. Annual percentage rate including cost of stock purchase. The cost of the stock purchase required on association and bank loans should be figured as a cost of credit and designated as a separate rate.

c. The impact of variable interest rates. If an institution uses a variable interest rate program, it must disclose the formula by which the rate is determined and the impact on the borrower of changes in the variable rates. In addition, the Farm Credit Administration shall promulgate regulations establishing or requiring the institutions to establish standards for the use of variable interest rates including: a formula or formulas under which the interest rate is determined; a maximum interest rate increase for a single year and for the life of the loan; and that borrowers will be given 30 days notice before any increase in the variable rate.

d. Policy in Regard to Default. The disclosure of the policy in regard to default shall include: 1) the circumstances which may constitute default; 2) that failure to cure a default may result in acceleration and foreclosure; and 3) the policy regarding forebearance.

2. Form of Disclosure

a. The disclosures required under subsection (1) of this part shall be made before the loan agreement is finalized.

b. The lender shall make the required disclosure clearly and conspicuously in writing, in a form that the borrower may keep. The disclosures shall be grouped together, shall be segregated from everything else, and shall not contain any information not directly related to the disclosures.

c. The disclosures shall be written in a clear and coherent manner using words with common and everyday meanings and shall be appropriately divided and captioned by its various sections.

d. The annual percentage rate and annual percentage rate including the cost of stock purchase shall be disclosed consecutively.

(Note: this provision is adapted from the Truth In Lending Act, 15 U.S.C. § 1638(b) and Regulation Z, 12 C.F.R. § 226.17.

II. ACCESS TO DOCUMENTS AND INFORMATION

A new provision:

The Farm Credit Administration shall promulgate regulations requiring banks and associations to provide borrowers with all documents material to the loan transaction, at the time such documents are executed or upon request, including, but not limited to the contract, mortgage, financing statements, and cash flow statements; and further requiring banks and associations to provide stockholders, upon request, with articles of incorporation, by-laws, local rules and policies, and loan manuals.

III. FAIRNESS AND RIGHT OF REVIEW

A. Amend 12 U.S.C. § 2201 to read:

§ 2201 Notice of adverse credit decision

Every loan applicant and borrower shall be entitled to prompt written notice of any adverse credit decision, the reason for such decision, and the right to review of the decision under section 2202.

B. Amend 12 U.S.C. § 2202 to read:

§ 2202 Review of adverse credit decisions

The Farm Credit Administration shall promulgate regulations, requiring each institution's board of directors to establish, from among its members, a credit review committee. Any loan application or borrower who has received notice of an adverse credit decision may, if he so requests in writing within thirty days of receiving such notice, request review of the adverse credit decision, in person before the credit review committee. Promptly after such a hearing, he shall be notified in writing of the credit review committee's decision and the reasons therefor.

IV. APPRAISALS

A new provision (adapted from 12 CFR § 614.4220(a) and (b)):

Primary real estate security shall be valued on the basis of appraisal value. Appraisal value is the reasonably supported market value, that is, the amount which a property will bring if a reasonable time is allowed to find a purchaser and if both seller and buyer are fully informed.

V. FORBEARANCE

A new provision (adapted from 7 U.S.C. § 1981a):

Pursuant to regulations, the Farm Credit Administration shall establish a procedure under which a borrower may request the deferral of principal and interest upon a showing by the borrower that due to circumstances beyond the borrower's control, the borrower is temporarily unable to continue making payments of such principal and interest when due without unduly impairing the standard of living of the borrower. The borrower shall be provided with written notice of the availability of deferral: (1) at the outset of the loan term; (2) at the beginning of each production season; (3) when a borrower is notified that he is delinquent; and (4) when a borrower is given an acceleration notice. The regulations promulgated pursuant to this section shall include a policy encouraging Farm Credit System lenders to work with other lenders and suppliers to resolve the fiscal difficulties of financially troubled borrowers. The regulations shall also incorporate special consideration for the preservation and maintenance of family living and farm operating expenses and collateral.

VII. CLAIMS AGAINST STOCK

Add to 12 USC §§ 2034 and 2094(f):

If the loan is in default, stock may be canceled for application on the loan only upon written notice and a right of review pursuant to sections 2021 and 2022 of this chapter.

VIII. LIQUIDATION OF INSTITUTIONS

Add to 12 USC § 2183(b):

Said regulations shall, among other things, direct institutions to ease the borrower's transition when a liquidation occurs, including, whenever possible, flexible financing for required new stock purchases, such as extending the time period in which such purchases may be made.

The Honorable Donald E. Wilkinson
Governor, Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22102-5090

Dear Governor Wilkinson:

This letter is written to share with you our concerns regarding current practices within the Farm Credit System. As you know, the past four years have witnessed a dramatic deterioration in the agricultural economy within our states. Thousands of farmers face insufficient cash flow, declining asset values, problems of access to credit, forced liquidation, foreclosures and bankruptcy. The latter fact is underscored by the record number of farm bankruptcy filings which have occurred this spring throughout the Midwest. See "Record total of farms use bankruptcy courts," Des Moines Sunday Register, March 17, 1985. The data suggest as well that the pressures pushing many farmers towards insolvency will continue in the near future. See, The Current Financial Condition of Farmers and Farm Lenders, Economic Research Service, U. S. Department of Agriculture - Agriculture Information Bulletin No. 490, p. 17.

Against this background, as the chief legal officers of our respective states, we have been contacted with increasing frequency concerning the range of economic and legal problems currently facing our farming communities. We believe that the experience of our states and the critical condition of the agricultural economy reflect problems similar in all agricultural states.

The present financial stress within agricultural communities has been transmitted to farm lenders through loan delinquencies, inadequate security and, in some instances, insolvency and the failure of lending institutions. The Farm Credit System itself currently holds over 30 per cent of all farm debt. Id. at X. Consequently, it has experienced increasing stress in recent years. Id. at 25. This stress on the Farm Credit System in turn has led, over the past six months, to an increasing number of complaints to our offices about its lending policies and practices. Our staffs have fielded inquiries from farmers across our states raising significant issues about local Production Credit Associations, Federal Land Banks, regional Federal Intermediate Credit Banks as well as general policies and procedures at the Farm Credit Board level. The spectrum of complaints is broad, and appears to reflect a serious impact not only on the Farm Credit System borrowers but farming generally. For the individual farmer it has often meant frustration and the threat of economic loss; in many instances it has meant the loss of the farm and a way of life.

In the Farm Credit Act of 1971, Congress expressly adopted the following declaration of policy:

> It is declared to be the policy of the Congress, recognizing that a prosperous, productive agriculture is essential to a free nation and recognizing the growing need for credit in rural areas, that the farmer-owned cooperative Farm Credit System be designed to accomplish the objective of improving the income and well-being of American farmers and ranchers by furnishing sound, adequate, and constructive credit and closely related services to them, their cooperatives, and to selected farm-related businesses necessary for efficient farm operations. 12 U. S. C. section 2001(a).

The increasing frequency of complaints from farm constituents has convinced us that abuses within the Farm Credit System are threatening this Congressional objective. If the Congressional purpose of improving the well-being of American farmers through the Farm Credit System is to be accomplished, reform is essential. By means of this open communication to you, we hope to bring to the forefront a range of problems within the Farm Credit System which threaten the well-being of farmers throughout our respective states.

This letter serves three basic purposes. The first is to share with you our profound concern over the dimensions of the farm credit problem. Second, we seek to identify specific problems in the Farm Credit System that we have recognized in working with farmers across the Midwest and to suggest reforms which may relieve these problems. Finally, we state that we are considering a petition for rulemaking before the Farm Credit Administration. In the interim, we seek to lay out the general range of issues that we have identified as being in need of review and revision by the Farm Credit System.

The discussion which follows is organized into six sections:

I. Disclosure of Terms
II. Access to Documents and Information
III. Appeal to Fairness and Review
IV. The Doctrine of Forbearance
V. Shareholder Rights
VI. Conclusion

These issues have been identified through repeated complaints by farmers within our states and highlighted the need for rulemaking and reconsideration of policy within the Farm Credit System.

I. Disclosure of Terms

We initially observe that, as a general rule, full disclosure of terms of any contract is of positive benefit to all parties. Many farmers have indicated that they were not given details regarding the terms of their loans. For example, farmers often are unaware of the effective interest rate on their loan or the variable interest rate mechanism. Furthermore, member borrowers are not made aware of what standards, if any, apply to the multiple rate loan levels at their Production Credit Associations. Finally, because of this lack of full disclosure, borrowers are frequently unclear about the potential effect of their loans on the cash flow of their operations.

We believe that the Farm Credit Administration should adopt rules which provide this very basic information.

First, we recommend that the Farm Credit Administration require that its member institutions incorporate provisions of the Truth-In Lending Act and Regulation Z as an essential element of their lending practices. Included in this approach would be a clear statement of the terms of the loan, including the annual percentage rate. We note that although some loan manuals and contracts allude to the Truth-In Lending Act, it appears that few Farm Credit System lenders adhere to its principles. It is also our belief that the effective rate of interest should reflect the additional costs of the ten percent stock purchase for Production Credit Associations loans and the five percent stock purchase for Federal Land Bank loans. This purchase is, in fact, an essential cost of the loan and adds between one and two percent to the actual rate of interest charged.

Second, when an interest rate is on a variable schedule, the lender should set out with clarity the potential future impact of that method of calculating the interest rate. To further clarify the application and function of variable interest rates, the lender should reveal the formula by which the rate is determined and disclose the factors upon which the rate is based. Most Farm Credit System lenders do not currently have any precisely defined formula nor any cap on the levels to which variable interest rates may rise. In the home mortgage industry, however, it is fundamental to have an accepted formula and an overall cap on both the variable interest rate and the total increase which can occur in a single year.

We believe that both farmers and Farm Credit System lenders would benefit from such disclosures, the farmer because it would allow for meaningful planning for expenses and the lender because fewer borrowers would find themselves in jeopardy because of unexpectedly high rates and consequent cash flow difficulties. In the same vein, it would be of benefit to all borrowers to be exposed to the potential effective rate changes on cash flow. Tables showing a simple computation of the rate, payment schedule and the effect of rate changes on the cash flow on the farm would be a positive aid to both farmer and lender as loan size and terms are discussed. Finally, the lender should give notice of an increase in the rate thirty days before it is to be implemented in order to allow borrowers the opportunity to consider alternatives.

Over the past few years, a new issue has arisen within the Farm Credit System with the advent of multiple rate levels for loans to different farmers within a given lending area. The Farm Credit Administration should evaluate whether this practice causes a steady failing of borderline borrowers by hastening their financial failure in farming. Even assuming that it is determined that the levels serve a beneficial purpose, the lender should establish and clearly disclose the standards and requirements for each rate level. Further, great care should be exercised to assure equal and fair treatment of each borrower similarly situated.

The other primary area of importance to the borrower at the time loan terms are discussed is the policy and procedure in the event of default. For example, the lender should inform the borrower about events which may trigger default, including a description of the right of the lender to deem itself insecure and accelerate the loan. The lender should specify the borrower's options when faced with default, including the right to review the situation with the lender, as well as the means of curing the default. The procedures for default and liquidation of stock should be made clear including the lender's policy relating to foreclosure.

To ensure that disclosures are properly made and are fully understood by the borrower we recommend that each lender in the Farm Credit System obtain a signed declaration of disclosure statement which fully describes the terms of the specific agreement as well as pertinent policies and procedures of the lender. Further, we suggest that the borrower be given the opportunity to review and consider the terms of the loan for three days after the disclosure statement has been signed. Finally, we urge that each disclosure statement advise in boldface type that the borrower has the right to consult a lawyer at any time during the negotiation or the term of the loan. Following these procedures will ensure that both the borrower and lender will be fully aware of their rights and responsibilities during the loan period at the outset -- thereby helping to avoid conflict and confrontation later.

Each district board is required by 12 C.F.R. section 611.1010(g) to adopt consistent lending and operating policies for each bank and all associations in the district. We would suggest that the Farm Credit Administration consider recommending that each of its members develop and establish policies which require a full and fair disclosure of the terms of loans to its customers. Not only should these procedures be enforced, but the resulting documents should be available for borrowers to examine in order to understand policies and procedures in effect.

II. Access to Documents and Information

One of the most common complaints about the Farm Credit System received by our offices concerns the failure of its lenders to provide copies of documents which should be available to the farmer. Access to documents and information is fundamental to good business practice, whether it be as a lender toward its borrowers, or as a corporation toward its shareholders. In either case, complete and open access serves both the Farm Credit System and its borrowers.

We recommend that the Farm Credit Administration require its member institutions to furnish all documents basic to the loan transaction to any farmer who borrows capital within the Farm Credit System. Currently, many borrowers report that they don't receive copies of their documents at the time of their loan; others find it extremely difficult or impossible to obtain copies of their loan documents. We see no logic or benefit to this policy. As a matter of course the borrower should be given copies of all documents which are basic to the loan transaction including but not limited to the contract, mortgage, financing statements, assignments, cash flow statements, the disclosure statement (if adopted), and other related documents. Certainly, any document which is signed by the borrower should be automatically available. Documents and information regarding policies and procedures of the lender should always be readily available to the borrower.

A similar problem confronts farmers in their role as Farm Credit System shareholders. While it has always been a policy of corporate and cooperative law in this nation to have open and reasonable access for shareholders to germane corporate documents this does not seem to be the practice within the Farm Credit System. Information received by our offices indicates that many Production Credit Associations have been reluctant to provide shareholders with copies of articles of incorporation, by-laws, local rules and policies or information on voting rights, all typically available to cooperative or corporate shareholders. We similarly encourage the Federal Intermediate Credit Bank to offer reasonable access to pertinent documents and policies. The Farm Credit Administration has already recognized that access to this type of information should be a general right of stockholders. See, 12 C.F.R. section 611.1125.

Finally, we would recommend that the Farm Credit Administration and its member institutions make available on a general basis copies of the loan manual presently used by the lender. We can think of no valid logic for not having this available to shareholder/ borrowers. It informs them on business procedures of their corporation while at the same time it acquaints them with what they can expect as borrowers. Finally, it allows borrowers to be aware of and enforce their rights. If lenders are proceeding properly, they have nothing to fear from disclosure. It is a healthy policy for all concerned.

In this context, we feel it is important to emphasize the need for information concerning the financial status of member institutions. Increasing financial concerns within the Farm Credit System demonstrate that there are serious questions about the true financial status of individual member institutions as well as the Farm Credit System as a whole. The initial problem is clearly the difficulty in obtaining accurate and meaningful reports on either regional or local entities within the Farm Credit System. We join others supporting a complete audit of local and regional entities within the system by the General Accounting Office.

Coupled with this request is a recommendation that the Farm Credit Administration evaluate current accounting principles and established standards and procedures to ensure that they will accurately reflect the true status of the Farm Credit System and its individual entities. At a time when the Farm Credit System claims severe loan losses and shares losses among districts and members, it is most important that loan losses be determined in conformance with generally accepted accounting principles. We would further ask that there be a statement concerning any change in the accounting methods in the past five years along with the report on the effects of that change.

III. Fairness in the System and Right of Review

One of the primary issues which has come to our attention is that of fundamental fairness for the farmer/ borrower in the Farm Credit System. There are three principal facets to this issue. The first is notice and the second is the need for a review procedure of lender decisions affecting individual borrowers. The third issue is the need for the system to adhere to the letter and spirit of its own policies, rules and regulations.

As a matter of Farm Credit System policy, borrowers should be given notice of impending activities or changes in their status within the system. Too often the borrower becomes aware of the change at a time when it is too late for both borrower and lender to take action potentially advantageous to both. Simple fairness dictates, for example, that a borrower who will not be renewed for an operating loan should be given timely notice, especially as it relates to current decisions. In one Iowa case a borrower was encouraged by his local Production Credit Association to buy three hundred heifers in November. Shortly after the heifers were delivered, the lenderr advised him that his operating loans were not to be renewed for the coming year. He was left with three hundred cattle and no source of funds to feed them out during the winter months. No valid purpose was served by the failure of the Production Credit Association to inform its borrower of the probable nonrenewal of the operating loan. In fact, neither borrower nor lender benefit from this approach.

The law now provides applicants with the opportunity for an informal review of credit decisions. See 12 U.S.C. section 2202 and 12 C.F.R. section 614.4441. However, in situation after situation reported to our offices, it is apparent that there is no meaningful internal review of decisions which can dramatically change the lives of farmers and their families. Fairness dictates that decisions vis-a-vis farmers should be afforded a full de novo review by a group of impartial board members or a committee established for the purpose of review and not merely a cursory reevaluation by the original loan officer and his or her immediate supervisor. The procedure currently in effect is unrealistic and unfair.

The Farm Credit System is founded on the principle of providing for farm credit through a farmer-controlled lender. It therefore makes sense to ensure that borrowers are given fair treatment and impartial review within the system if they believe that a loan officer has made a wrong decision or placed the borrower in an untenable situation. For example, review should be available not only when credit is denied or reduced but when there is: (1) notice of the need for new or increased collateral, (2) notice of acceleration of a note when a loan is deemed insecure, and (3) an issue of forbearance. Fairness can only be attained by creating a more clearly defined procedure which will make certain that there is a review by persons not concerned with the original transaction.

Finally, employees of the Farm Credit System must take care to adhere to the applicable regulations. One clear example is revealed in the rash of complaints we received concerning loan officers' practice in past years of encouraging farmers to borrow more money than needed or requested. No doubt the farmers were pleased with the confidence of the loan officers in their ability to manage operations of increasing size. Loan officers did not disclose that they were paid in part on a commission basis, and therefore their pay depended upon the amount of money they could put into farmers' hands. In some cases prizes and trips were awarded to officers who loaned out the most money. It would appear to us that such a program creates a direct conflict of interest between lender and borrower. Not only is it bad policy but it runs counter to 12 C.F.R. section 601.110(d), wherein officers and employees of the Farm Credit System are prohibited from accepting any commission "which might reasonably be interpreted by others as being of such a nature that it could affect his impartiality." Farm Credit regulations are designed to serve both borrower and lender and should be scrupulously followed.

Another example of the failure to lenders in the Farm Credit System to adhere to current regulations and establish standards is in the appraisal of land value. While the regulations establish the general principle of appraisal at 12 C.F.R. subsections 614.4220(a) and (b), the lenders have instead adopted a policy using a few "benchmark farms" to value real estate for an entire state. For example, the Federal Land Bank in North Dakota, a state with 36,000 farms, uses only sixteen "benchmark farms" to establish land values for all farmers even though thirty-six counties do not have a "benchmark farm" within their borders.

IV. Doctrine of Forbearance

We urge the development of a well-defined standard and procedure for implementing the policy of forbearance set forth in the regulations. In this regard, we particularly encourage forbearance when the borrower is unable to make payments as a result of circumstances which are beyond his or her control. The forbearance standard should also include a commitment by Farm Credit System lenders to work with other lenders and with suppliers to resolve the fiscal problems of financially troubled farmers. Finally, the standard should incorporate special consideration for the preservation and maintenance of family living and farm operating expenses as well as the value of collateral. These needs of the borrower should be given priority in the use and distribution of income in order to maximize the borrower's ability to "[work] out of the debt burden." 12 C.F.R. section 614.4510(a)(1).

Whatever the standard for forbearance is, and even if it remains the simple statement currently included in the regulations, we urge the Farm Credit System lenders to provide borrowers with personal notice of the availability of forbearance. In order to enhance the borrower's awareness in this regard, we suggest that borrowers be notified of the availability of forbearance at four points during the loan process: (1) at the outset of the loan term; (2) at the beginning of each production season; (3) when a borrower is notified that he or she is delinquent; and (4) when a borrower is given an accelerated notice. See Curry v. Block, 738 F.2d 1556, 1562, (11th Cir. 1984) (Farmers Home Administration's duty to implement deferral relief program under 7 U.S.C. section 1981a).

V. Rights of Shareholders

Although the principal relationship of the farmer to the Farm Credit System is that of borrower, he is also a shareholder by virtue of the requirement that he purchase a certain amount of stock in the lender when obtaining a loan. As shareholders, farmers are entitled to the disclosure of certain information and records relating to their rights as shareholders. We would go on to observe that additional rights ought to be established and protected.

First, we recommend that all loan agreements require that shares held by a farmer be retired on a pro rata basis as the note is paid off. The recent practice established in the Iowa Production Credit Association stock freeze of retiring the stock at the end of the loan period is a serious disadvantage to the borrower. As it currently stands farmers in the areas of frozen Production Credit Association stock have up to $40 million unavailable at a time when credit is extremely difficult to obtain.

Second, stockholders should be notified of any rights or claims the lender may have against stock held by farmers and any impending action which might adversely affect the value of that stock. As an example, notice and right of review should be accorded the individual farmer if stock is being used to offset a loan.

Third, although we discourage liquidation as a solution to Farm Credit System lender difficulties, should this step be necessary, the rights of stockholders should be protected to the maximum extent possible. Stockholders should be given notice of the proposed liquidation and a reasonable opportunity to respond. Although the Farm Credit Administration has adopted limited regulations in this regard, see 12 C.F.R. section 611.1163 (proposal at 50

Fed. Reg. 6002), the proposed notice provision is inadequate. See comments of Attorney General Nicholas J. Spaeth dated May 7, 1985; and Attorney General Hubert H. Humphrey, III dated March 13, 1985, joined by Attorney General Thomas J. Miller dated May 10, 1985. In addition, we urge the Farm Credit Administration to direct its member lenders to ease the transition when a liquidation does occur. Whenever possible, the Farm Credit System should liberalize the financing for required new stock purchases in such circumstances, including, but not limited to, extending the time period in which such purchases may be made.

Fourth, we are further concerned by the lack of standards or factors within the Farm Credit System for the payment of dividends to its members. We understand that in the past it has not been the practice of member institutions to pay out dividends, even in profitable years. We urge that this practice be reevaluated, and that the Farm Credit System set reasonable standards for payment of dividends. We believe that this policy should be set forth in the by-laws of the lending institution. Further, we would suggest that a study be made concerning the treatment of profits over the years, and particularly in the past fifteen years.

Last, we believe that the original philosophy of the Farm Credit system as locally owned, farmer controlled lenders is being threatened by increased system centralization. Over the past decades the supervisory role of the Farm Credit Administration has increased until it now appears that the Farm Credit System policies are set at the national and regional levels while the original concept of local control has been largely extinguished. This trend is continuing and accelerating as illustrated by the recent creation of the Farm Credit Corporation of Denver as the central policy making institution for the entire system. One recent example of loss of local control was found in the Federal Land Bank Association in Lamoure, North Dakota.

Having suffered losses due to long-term drought, the Association's Board contemplated merger. The St. Paul District office broadly intervened and attempted to take control entirely from the local board by a refusal to recognize the board or to make money available through the board as well as the filing of a lawsuit. The problem was resolved with the help of the North Dakota Attorney General.

Of equal significance is the recent decision by the Omaha District office which has proposed to forbid board members from holding office if their loans are placed in a problem category. This, in effect, takes away the traditional right to vote for the person the shareholder chooses for the board of directors as well as prohibiting a shareholder from seeking a position on the board.

VI. Conclusion

The current difficulties in American agriculture are taking a dramatic toll on farmers as well as on the Farm Credit System, the major agricultural lender in the country. This is a time for reevaluation and reconsideration of policies and procedures which will serve both the Farm Credit System and its farmer borrowers. The recommendations in this letter and the petition for rulemaking which will follow seek to remedy patterns of problems which have emerged with frequency in the complaints by farmers. These suggestions and the ensuing rulemaking are submitted in the belief that meaningful benefits will result for lender and borrower alike.

The regulations of the Farm Credit System are designed to help member institutions succeed as lenders and to serve farm borrowers. Each of the regulations should be enforced by local and regional offices as well as by the Farm Credit Board. The spirit of service and responsibility to farm borrowers should be the primary guide to the application of current regulations and the adoption of appropriate new regulations.

In Allison v. Block, 723 F.2d 631, 638 (8th Cir. 1983), the Eighth Circuit Court of Appeals, in describing a program within the Farmers Home Administration, wrote:

> We realize that the plight of many farmers throughout the nation is so bleak that the forbearance of creditors will not save their operations. We are also aware, however, that the agricultural industry is especially vulnerable to the changing winds of time, nature, fate, and the economy; farmers of skill, perserverance, and dedication are no less vulnerable. Congress in 1978 clearly expressed its intent to assist farmers blown astray by these winds by granting those who could show that their inability to meet their financial obligations were temporary more time to repay their debts to the government. It commissioned the Secretary to implement this intent not as a private banker, but as a public broker....

American farmers are no less vulnerable to the abuses within the Farm Credit System than the changing winds of time and nature. We write this letter to urge that reforms be undertaken to enable the Farm Credit System to again function in the public interest. In that way agriculture, so basic to our well-being as a nation, can be returned to a healthy and productive condition.

Sincerely,

NEIL F. HARTIGAN
Illinois Attorney General

LINLEY E. PEARSON
Indiana Attorney General

THOMAS J. MILLER
Iowa Attorney General

ROBERT T. STEPHAN
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NATIONAL
FARMERS
UNION

STATEMENT OF

CY CARPENTER
PRESIDENT
NATIONAL FARMERS UNION

PRESENTED TO THE

SUBCOMMITTEE ON CONSERVATION, CREDIT
AND RURAL DEVELOPMENT
COMMITTEE ON AGRICULTURE
U.S. HOUSE OF REPRESENTATIVES

CONCERNING

"THE AGRICULTURAL CREDIT CRISIS"

WASHINGTON, D.C.
OCTOBER 31, 1985

Mr. Chairman and Members of the Subcommittee:

My name is Cy Carpenter, and I am President of the National Farmers Union, a general farm organization. I represent the family farmers and rural communities of this nation. I am always honored to appear before this Subcommittee and its distinguished and hard-working Chairman. I wish I could say this is a happy occasion. Rather, I appear before you today with a great sense of urgency and concern that unless Congress acts quickly and decisively, hundreds of thousands more of our farm families and banks and small rural businesses will be forced out of business over the next several months.

Let me come straight to the point: What we have in agriculture today is not a credit crisis, it is an INCOME CRISIS!

I am, quite frankly, disappointed and angry, and I know you are, that we must come together again to plead with the rest of Congress and the Administration to realize what is happening in rural America, not only to our farmers and ranchers, but to our rural communities with their small businesses, schools, and churches. Our entire economic and social structure is terminal under the present conditions. Now the economic and social consequences of the depression in rural America have infected the financial community and threaten our entire economy. We have already lost a quarter-of-a-million off-farm jobs because farmers can no longer purchase the equipment and input items that are made by those laborers.

If farmers and ranchers were getting a decent price for their wheat and corn and cattle and cotton, there would be no crisis for farmers or their lending institutions. There would be no problem with plummeting land values leading to a collateral problem, no problem with private lenders foreclosing on farmers, and no problems with government lending institutions.

Therefore, National Farmers Union must stand opposed to a (and we hesitate to call it a "bail-out") re-financing or underwriting for the Farm Credit System and other lenders, UNLESS that plan also provides for restoring income to farm families so they can repay their debts. Without the ability for farmers to repay those debts, any re-financing could at best be only temporary, and would eventually destroy the Farm Credit System.

The answer to this crisis is fair prices to farmers on their commodities -- the same remedy which rescued the Farm Credit structure when it was undermined by low farm prices in the early 1920s and again in the early 1930s.

Yes, there was some federal help in each instance, but it was the dramatic recovery of farm prices and income which enabled the Farm Credit operation to become viable again.

Now, in 1985, the situation of the Farm Credit System is more precarious, while the farm price rallies which turned the tide in the 1920s and 1930s are nowhere in sight. What we face is not the hope of recovery, but the reality of a steep decline in prices and income.

We are not interested in "bailing out" the non-farm investor in the Farm Credit System at the expense of the farmer-cooperator. The farmer is also an investor in the Farm Credit System -- farmers have put $5 billion of their own capital in it. If the Farm Credit System is to be revitalized by additional funding, the farmer and his cooperative will carry the whole load of repayment.

NFU is TOTALLY SUPPORTIVE of the important role the Farm Credit System has played and will, we hope, play in the future of family agriculture. We helped establish the system and have been supportive for the past 50 years. We are equally supportive of corrective action to solve the current problems, by providing farm income and the additional availability of funds to the Farm Credit System as necessary. Let me stress that there is nothing fundamentally wrong with the Farm Credit System which would not be cured by a return to realistic farm prices and income.

With the following conditions before agriculture today, what lending institution -- private, cooperative or federal -- could realistically provide credit to farmers without hope that they could earn an income to repay it? NONE. Not only would it be poor business, it would only add to the quicksand pull that is forcing many lending institutions out of business alongside their farming clients.

Here are a few observations about the true conditions facing today's agriculture and its lending institutions:

*Prices received by farmers for most major commodities are running 20 to 25 percent below a year ago. Prices are forecast to be even lower in 1986.

*Net farm income for 1985 is forecast between $23 and $27 billion, compared to $34.5 billion in 1984.

*Farmers' return on equity will be negative for the fifth consecutive year in 1985 and may run a minus 20 percent or more.

*Exports of farm commodities are forecast at $32 billion, nearly 16 percent below 1984. Volume is expected to be off 10 percent from a year earlier. No upturn in either export value or volume is expected for 1986.

*Land values are off in many Midwestern states by 20 percent from the previous year and are only about half of what they were five years ago.

We recognize the fact that, if we are to keep a substantial number of farmers in business, some emergency action by the Congress, the Administration, and the lending institutions will be necessary. Even if Congress were to pass the best possible farm bill this year, the price and income provisions of that bill would not be effective until the middle of next year, and that would be too late for many farmers.

As it stands now, the Farm Bill currently working its way through the Congressional process is not adequate to improve farm income and the rural depression will worsen.

In addition, National Farmers Union stands on record now that assistance for the Farm Credit System must remain completely separate from the funds allocated for farm program spending. If this funding is tied together, both programs are sure to fail.

In the meantime, action must be taken to assure agricultural lenders of obtaining adequate loan funds at reasonable costs through the Federal Reserve System.

Recognizing the need for emergency action, however, is not a blanket endorsement of a simple "bail-out" of the lending institutions, cooperative or private. We will question any measure that simply, and only temporarily, bails out the lending institutions and leaves the farmers with declining income and no prospect of improvement in commodity prices and income. What good will a simple bail-out do if farmers cannot repay their existing debts?

The fact is that unless there is a turn-around on the income front, things will be worse next year and an even bigger bail-out will be needed. The longer farm price recovery is delayed, the costlier any bail-out will be. Today's $10 billion bail-out will double by next March and double again by next October if nothing is done about farm income. Instead of improving farm income, the 1985 farm bill, as it now stands, is likely to cut it by 20% in the next three years. No one should be surprised when a $20 billion bail-out is needed in March or a $40 billion bail-out in October -- national policy has invited exactly that result.

The federal Farm Credit System, which provides agriculture with about one-third of its borrowed funds, will suffer an operating loss for the year. About $11 billion, or 15 percent, of its loans are now considered uncollectible, and this will become even worse as prices and income continue to decline.

Let me deviate just a bit from the topic at hand, although this problem relates directly to the financial soundness of the Farm Credit System.

We were alerted last month to a potentially dangerous situation developing in the Wichita and Omaha Farm Credit Districts. A local Federal Land Bank Association in Kansas offered for sale several tracts of land at a preferential interest rate and waived the mandatory cooperative stock purchase for buyers of those specific tracts of land. In the Omaha district, I understand that a substantial interest rate reduction has also been offered on several tracts of land sold by individual FLBAs on contracts for deed.

I believe both sales -- and the Kansas sale was open to bidders from across the country, member-borrowers or not -- violate the intent of Congress. The Farm Credit System and its Federal Land Banks were created to finance family farmers, not investors and speculators, and not to give preferential treatment to non-member borrowers.

It is true that this land sale is being conducted under duress. This is not the normal behavior of the Farm Credit System. However, unchecked it will eventually destroy the System.

It comes down to an issue of fairness: Why aren't these interest rate breaks and stock payment waivers available to existing borrower-owners who are struggling to keep their farms and repay their FLBA loans?

As you investigate this situation, please consider it as part of your consideration of assistance to the Farm Credit System. I strongly urge you to conduct an investigation. If this specific Kansas sale is considered successful, it will be used as a model for other sales across the Wichita Farm Credit District, and perhaps across the nation. I don't believe it is in our best interests as a nation to allow that to go forward. I believe the Farm Credit System owes its first allegiance to its existing member-borrowers who have built the cooperative. I believe this discrimination is fundamentally wrong.

On the commercial side of farm credit, about 400 of the 1,000 banks on the FDIC's "problem list" are agricultural banks. Of the 56 bank failures by July 1, 1985, about half were "agricultural banks," those with 25 percent or more of their loan portfolio in agricultural loans.

The sad part of all this is that we need not be in this situation. We, along with other responsible organizations, saw what was about to happen if the Administration went ahead and implemented its farm policy. Even though the Congress gave the Administration ample authority to implement supply management programs to eliminate burdensome production levels while providing food for our nation and other hungry people in the world, they chose to implement the law only to the degree absolutely necessary to comply with Congressional mandates. As a result, inventories of all basic commodities continued to increase. It was no secret what was about to happen.

On May 18, 1982, before a special meeting of the Committee on Agriculture, National Farmers Union presented its report, "Depression in Rural America." At that time, we presented to the Congress the facts of what was already happening in the rural economy and community and accurately predicted the course of events that has come to pass.

I want to compliment the Committee on Agriculture Chairman Kika de la Garza, and this Subcommittee's Chairman Ed Jones, for their foresight then and now in recognizing the growing severity of the problem. Three years later, conditions continue to deteriorate and the Administration and others stubbornly refuse to recognize this misdirection or the need for farm income. We calculate the holdings of the Farm Credit System to be declining by $1 billion per month. With farmers and their demonstrated inability to repay their loans, a second, third and fourth bail-out may be needed unless income is an integral part of any plan. The need for more than one bail-out would certainly destroy the credibility of the Farm Credit System and must be avoided.

Recognizing the growing economic and credit problems in the farm sector, Congress passed on Wednesday, February 27, 1985, H.R. 1035, "The Emergency Farm Credit Act." Unfortunately, and in a very callous manner, the President vetoed this modest proposal. In its place the Administration offered token programs, none of which helped stem the tide of farm failures.

Now, in the fall of 1985, we find ourselves again faced with a crisis situation, one brought on by continued low farm prices. Again, farmers will be searching for a way to hang on for one more year, trying to make their payments on last year's loans and arrange financing for next year's crops.

Having said that -- and recognizing the importance of all three sectors of the agricultural lending system: private, cooperative, and FmHA -- we are anxious and willing to work with Congress in any realistic attempt to resolve the immediate crisis, provided we have some assurance that at the same time, the Congress will address the price and income situation in a realistic manner. Congress is still in the process of working on the 1985 Farm Bill. Improvements can still be made. We simply cannot survive with the status quo or anything less. Emergency credit: Yes! Help for the financial institutions: Yes! But this can only succeed if accompanied by rising farm income.

Any emergency action taken by the Congress, the lending institutions, or the FmHA will have to address: 1) the needs of individual farmers to meet their debt obligations and secure financing for next year's operations; and 2) the institutional needs of the lending agencies.

To address the needs of individual farmers facing immediate note payments and obtaining operating capital, the following measures need to be implemented:

1. Borrowers in all three sectors -- private, cooperative, and FmHA -- must be permitted to restructure their debt allowing for repaying of principal and interest over an extended period of time at levels commensurate with their income.

2. Farmers Home Administration borrowers should be permitted, on a case-by-case basis, to defer payments on principal and interest.

3. Government guaranteed operating loans should be made available to borrowers through private lenders and to those producers who do not qualify for FmHA loans.

4. FmHA should be required to make direct operating loans to qualifying borrowers, whether new or current.

5. The Approved Lenders Program should be expanded to allow private lenders to use FmHA programs for their borrowers.

6. Loans and service provided through the Small Business Administration must continue to be available to farmers.

For those lending institutions serving agriculture, the following actions need to be taken:

1. Where necessary, agricultural banks should be assured of obtaining adequate loan funds at reasonable costs through the Federal Reserve System.

2. Congress must increase the Farmers Home Administration's appropriations for low interest direct operating loans.

3. Congress must provide direct appropriations for interest rate buy-downs.

4. A federally-chartered corporation should be established to assume temporary control of farm and ranch land which has been foreclosed or forfeited to any lending institution. (Provided that there are adequate safeguards written into the law to protect the interests of the previous owner. Lease and/or purchase of any land held by the corporation must be made only to individual farm operators, with the first right to the previous owner and secondly to beginning farmers.)

Once again, the cost of a bail-out as a cost to the Farm Credit System and other lenders is really an additional cost to farmers. They will bear the brunt of that repayment out of their shrinking income.

In order to be successful in implementing these recommendations and resolving the immediate crisis, Congress must appropriate adequate sums of money, the Administration must carry out effectively the intent of Congress, and the lending institutions, be they private or governmental -- as well as the investors -- must absorb a share of the losses themselves.

While tragic losses are already occurring, the worst can still be avoided.

What are needed are preemptive or preventive tactics, not postmortem autopsies.

If this Congress and Administration fail to act until after a far larger disaster, this cost will be correspondingly greater.

It is still not too late to do something about the Food Security Act of 1985. Failing that, the first order of the second session of this Congress will need to be an emergency farm bill. We pray that prompt action in that direction will be taken now.

A final point, because the farm lending crisis grows more serious each day. A quarterly review of the Farm Credit System's finances shows a $500 million loss, with projections of a $3 billion loss through 1987. The situation is deteriorating so rapidly that it demands emergency steps be taken. We ask that you call for an immediate halt to all foreclosures and liquidations by the Farm Credit System, the FmHA or other government lenders until a solution can be worked out.

I reiterate, Mr. Chairman, that all of these measures will be to no avail unless the basic underlying problem is addressed -- an adequate price for farm products and income for farmers in order that they may repay their obligations.

Thank you.

NATIONAL
FARMERS
ORGANIZATION

Subcommittee on Conservation,
Credit, and Rural Development
Committee on Agriculture
U.S. House of Representatives

STATEMENT
RENE F. NIESE
Treasurer and Trust Administrator
National Farmers Organization
October 31, 1985

FARM CREDIT

Mr. Chairman and members of the Subcommittee, first let us thank you for arranging this hearing and providing time for us to appear before you today. Mr. DeVon Woodland, our National President, farmer and rancher from Blackfoot, Idaho, had made plans to be here because he recognizes the dire credit circumstances prevailing throughout most farm communities of the United States. He has asked me to bring his personal greetings, explain that unavoidable circumstances forced him to return to Idaho this week and to present our views.

As the officer responsible for our organization's financial assets, and one who is in daily communication with our members and with business people who deal with farmers, I come before you with some understanding of the complexity of the problems in the farm credit field and a feeling of heavy responsibility to convey our concerns.

We are advised that about $50 billion of the $212 billion in total agricultural debt outstanding today cannot be serviced through 1985 and 1986 unless we substantially increase the cash flow for our farm producers. We are told that the Farmers Home Administration holds roughly $32 billion of that total debt and $6 to $7 billion of it is twelve months or more past due.

The Federal Farm Credit Banks Funding Corporation has just publicly acknowledged losses totaling $426 million in the first nine months of this year. Perhaps it is even more alarming to note that loans classified in the non-accrual status increased from $2 billion as of June 30 of this year to $3.5 billion by the end of September. Those numbers correlate with the rapid increase in reported bankruptcies and close-outs coming to us through our own channels.

I am told that, of the 56 banks that failed before July 1 this year, at least half of them were heavily involved with agricultural loans. I am also advised that about one half of the banks on the FDIC "Watch List" are agricultural banks, i.e., those with twenty-five percent or more of their loans that are farm oriented. Agricultural credit from this source annually amounts to $40 to $50 billion of the $212 billion mentioned earlier.

On February 7, 1985 our Washington office director, in an appearance before your Subcommittee, emphasized how rapidly our farm credit structure was approaching a crisis. He cited the Federal Reserve Board's report that farmers and ranchers had lost $250 billion in asset values over the previous four years. We called for expansion of the FmHA direct loan program and an interest buy-down for reliable producers in the mid-range size of operation. We also urged you to put a "stop" order on FmHA foreclosures for a reasonable period of time.

As we look back over this year, we are convinced of the validity of those viewpoints. You did initiate action in the Congress and were frustrated by the Administration's veto of your legislation. The administrators of the FmHA program may have let up somewhat on foreclosure actions, but the feeling running throughout farm communities has moved from one of dissatisfaction and concern to an attitude of despair. Many people have become so discouraged that they have grown very quiet. They come to our meetings to talk about bargaining, prices, interest rates and related concerns, but they no longer express confidence that Washington is going to help.

This is the severe challenge facing you today. Can you help? Is the Congress going to move with enlightened legislation or are we to be continually confronted with the stand-off between the Congress and the Administration such as we have experienced over the last twelve to eighteen months? We urge you again to move decisively, based on your own good judgment, and let the Executive Branch be responsible for its own decisions.

GUIDELINES FOR ACTION

The Farm Credit System. Don't bail out the investors and financial institutions unless you are going to strengthen the cash flow for the individual owner-operators in the mid-range of farming. Failure to take this precaution will only mean that you must repeat the action in the future until we can afford to pay our debts.

We are flexible in our attitudes on what should be done on farm income. For example, you could move to increase price supports but stay in the budget by denying entry to the farm program to foreign investors and institutions whose main business is other than farming. You could insist on cross compliance and strong administrative actions to clean up program administration. You could restrict importation of competitive farm products coming out of subsidized farming in other countries (pork and casein, for example). You could reverse the recent decline in administration of the federal grain standards that influence our grain exports.

This is by no means a complete or well organized set of corrections for the farm bill currently moving in the Congress. We are trying to illustrate, however, that something worthwhile must be done about farm income if we are ever going to reduce the credit dilemma to manageable proportions.

Reorganization. Keep control of any reorganization of the Farm Credit System. We are aware of the mounting demands for government to step in with five to six billion dollars in guaranteed financing to reinforce investor confidence and possibly reverse the trend of increasing bond and interest rates. The Administration is expected to insist that this be accomplished only if a new controller or regulator is installed to run the system.

Although we must acknowledge that information made available in recent months would justify a change in authority and management, we warn against complete loss of touch with the farming community at the level of control necessary to unify sound operational policies throughout the country.

We suggest that the system has become ingrown and self-serving in some districts. Any reorganized central authority must have producer representation. There are some districts where the management either is more proficient and capable or they have enjoyed a better mix of good weather and fair prices. In these areas they do not relish release of capital or control to a central authority -- or higher interest rates for their cooperators -- to help other areas. Nevertheless, the Farm Credit System is national in scope and nature. Such new underwriting or guarantees as you may provide should be prefaced on the assumption that the resources of the whole system will be committed to meet the overall requirements of that System on a national basis.

It should also be noted that our best information indicates that any action to be undertaken should be forthcoming quickly. It would not be wise to delay meeting this crisis until next year and force the dissipation of all reserves remaining within the System.

Form of Assistance. In order to meet the obvious urgency of aiding the whole Farm Credit System, action must be taken soon. If you start with that assumption, there probably will not be time to establish a modern Reconstruction Finance Corporation to serve as a central banking agency for all the farm financial institutions. Yet, it would be wrong to refinance the System and extend no relief to the independent banks who carry about $40 billion of farm operating debt in addition to their land loans.

We suggest that it may be best to report a two-part bill. Deal with the Farm Credit System by underwriting bonds in the money market and extend an improved and enlarged guaranteed loan opportunity through the FmHA.

It probably will be necessary to move with a combination of stronger direct loan action and a modified guaranteed loan arrangement containing an interest buy-down feature. It is not unreasonable to ask the bank to reduce interest rates by two percent while offering another matching two percent cut from federal funds to encourage private banks to carry clearly qualified farm borrowers who can survive with such an arrangement, but who are otherwise going under.

A parallel action should authorize and direct FmHA to assume some land loans now carried by the banks where the producer is well qualified and the bank will discount the loan rather than push a foreclosure and sale of the land at current price levels. In this case the producer must be relieved of the loan obligation proportionate to the discount.

Kansas Land Sale. Recent land sales directed by the Wichita Federal Land Bank and conducted by the Colby Federal Land Bank Association illustrate the type of action we do not want in Rural America. As we understand it, the Association offered seventeen parcels of land and succeeded in disposing of twelve of them. Special credit arrangements were offered by reducing the interest rate below that available to regular borrowers and foregoing the stock purchase requirement. Informal reports indicate that no specifications were used to limit sales of those parcels to individual mid-range producers.

If the Farm Credit System personnel are not willing to regard our native farm people, who have served the nation through war and peace for generations in any light, different from that afforded tax dodgers and foreign investors, then we are not concerned about saving the System. We trust the Wichita pilot process will not become a regular mode of operation in the System. The stockholders in the Associations deserve more thoughtful consideration.

Producer Interests. We recommend that you undertake to establish certain priorities to be observed in the administration of any reorganized credit arrangement resulting from new legislation:

(1) Regardless of whether a borrower is in the Farm Credit System, the FmHA group, or is serviced by private banks utilizing the guaranteed loan feature, first consideration should be given to refinancing and permitting a present borrower to stay on the land if the family is capable, hardworking and making an effort to meet financial obligations.

(2) In the leasing or sale of land that has or will come into possession of one of the agencies, every effort must be made to place that land with an individual mid-range owner-operator.

(3) A reasonable balance among agencies and institutions as to the availability of credit should be maintained. In other words, this crisis should not be permitted to change substantially the proportion of farm credit carried by the Farm Credit System, the FmHA and private banks if such a shift can be avoided.

To summarize, in this brief presentation we have concentrated on the need for increased net farm income, revitalization of the credit agencies serving farmers and what may be done legislatively to correct some grievous policy directions of the past. Perhaps it would also be well to think of the possibility of positive accomplishment that may come out of this price and credit crisis. We have nearly lost the family farm system that has proven to be so successful in the past and served as an important part of our heritage throughout our history.

In the placement of properties they now own or those coming into their possession in the near future, the credit agencies would do well to search for young farm families capable of making a new start in farming. To accomplish such a goal, local leaders in the credit institutions will have to take the initiative. Many of the judgments and decisions will be subjective in nature and may involve some risk. Nevertheless, we harbor the hope that this farm economy can be turned around.

When that occurs, we would like to think that those who will control the land, the small business houses and the future of community affairs in Rural America will be people with long-standing interests in those communities. We will have little faith in a total system based upon absentee ownership and a large floating tenant population whose commitments can only be of a short term nature. Most of our ancestors came here to get away from that system. As an organization, we resent that old system following us here and now destroying the very communities that are such an important part of America. We built them -- we want to keep them -- and we think it is in the country's interest to do so.

Mr. Chairman, again we thank you and the members of this Committee for the opportunity to present our views. We offer to work with you if a bill is to be forthcoming.

STATEMENT OF THE AMERICAN FARM BUREAU FEDERATION BEFORE THE SUBCOMMITTEE ON CONSERVATION, CREDIT AND RURAL DEVELOPMENT OF THE HOUSE AGRICULTURE COMMITTEE REGARDING CREDIT LEGISLATION

Presented by
Robert B. Delano, President, American Farm Bureau Federation

OCTOBER 31, 1985

Thank you, Mr. Chairman. My name is Robert B. Delano, and I am President of the American Farm Bureau Federation, the nation's largest farm organization.

The events of the last several years have made credit issues of prime importance to the Farm Bureau. As you may recall, we were involved in the debt adjustment program in September, 1984 and the proposal to advance price support loans to assist in financing the 1985 crops. Our first concerns are for farmers. That is not to say that we will ignore the problems of lenders, but we will first look at the impact any program has on agricultural producers.

We must arrive at solutions which truly help farmers and ranchers and, at the same time, ensure the integrity of the financial systems serving farmers. The effort will fail if we save farmers but lose the local financial institutions which farmers depend upon. Likewise, if we save the financial systems in such a way that they no longer serve the best interests of farmers, we have also failed. The eventual steps taken by the Congress and the financial institutions will be very critical to the future prosperity and income opportunities for all of agriculture.

Much recent attention has been focused on the Farm Credit System and its deepening financial difficulties. The debt problem in agriculture is much wider than just the Farm Credit System. The system has only about one-third of the outstanding agricultural debt. Many Farm Bureau members rely on local banks, farm suppliers, insurance companies and individuals for credit. Any credit assistance programs must be balanced among all lenders, not to just the Farm Credit System.

Any actions on credit that Congress might take must recognize that the expansion of debt that occurred from 1972 to 1982 cannot be handled based on the expected income over the next few years. Some segments of agriculture are simply carrying too much debt in relation to the earning power of the assets they control. No program will succeed unless the debt load is reduced for the one-third of commercial farm operators that hold two-thirds of the commercial farm debt.

These producers are carrying a debt load that cannot be serviced based on likely farm income over the next several years. Another low cost loan that increases debt load or an interest subsidy for a year or two will not provide a long-term solution. Their debt load must be reduced so it is more in line with potential earning power of the underlying assets.

This is not to say that the two-thirds of family operators with one-third of the debt should be ignored, but rather that the one-third has the most severe difficulties. All farmers will benefit from efforts to lessen the burden on the farm credit institutions. Care must be taken to insure that the positions of the other two-thirds are not weakened by policies aimed at the one-third in worst shape.

Any plan put forth will not prevent financial losses for farmers, lenders and taxpayers. Since farmers and lenders were the creators of the debt, solutions must involve those same producers and lenders. Government assistance to either producers or lenders should be structured to ease the financial adjustments that must take place. As I said earlier, adjustments of debt to earning power must occur.

The first instinct of many people is to hastily enact a program or series of programs. Since actions taken will have a major long-term impact on agriculture, the utmost care must be taken to ensure that actions taken now do not cause more problems a year or two from now. There continues to be a great amount of dispute about the true financial situation of the Farm Credit System, banks and other lenders. These discrepancies must be cleared up before decisive action can be taken.

Likewise, there is considerable dispute about the amount of debt held by farm operators. Most people have accepted USDA's estimate that total agricultural debt was $213 billion on January 1, 1985. Yet another USDA study showed farm operator debt at about $120 billion on January 1, 1985. These huge differences in estimates of debt load cannot be dismissed lightly. The figures indicate that some people who are not farm operators either have borrowed money to purchase agricultural assets or have used agricultural assets as collateral to borrow for non-farming purposes. Our concern centers on agricultural producers, not on these other people who may have nonfarm income that allows them to manage this debt.

Mr. Chairman, Farm Bureau is very interested in the impact on farmers of any policy solution to the debt problem. We are concerned that the real issue of too much debt load relative to ability to pay be kept separate from other issues. We want to make sure that the facts pertinent to policy solutions are clearly defined before actions are taken. And, finally, we want to make sure that any solution maintains the delicate competitive balance that exists among all farm lenders. Farmers surely want to avoid becoming dependent on one source of credit.

In conclusion, Mr. Chairman, we are very aware of farmers' current financial situation. Like Congress, which must deal with this complex issue, we find at this time that there are more questions about, than solutions for, our debt and credit problems. Farm Bureau looks forward to working with the committee in developing solutions to these farm debt and credit problems.

STATEMENT OF
BEN F. MORGAN
EXECUTIVE VICE PRESIDENT AND CHIEF EXECUTIVE OFFICER
DAIRYMEN, INC.

Mr. Chairman, I am Ben Morgan, Chief Executive Officer of Dairymen, Inc. and Chairman of the Board of the National Council of Farmer Cooperatives. I appear before you today on behalf of the nearly 6,000 local farmer cooperatives represented by the National Council and their nearly 2 million farmer members.

These local cooperatives are part of the Farm Credit System in two ways. First, their farmer-owners have borrowed from the System for their operations. Secondly, the cooperatives have borrowed and hold stock in the System.

In 1984, the largest 100 farmer cooperatives had nearly $500 million invested in the Banks for Cooperatives. At the same time over one-half of the $6.4 billion of these cooperatives' debt came from the Banks for Cooperatives. This underscores our basis for concern and support for appropriate and necessary actions to address the financial problems faced by our farmers.

Our primary concern is the financial health of our farmer-members. For if farmers are having problems then cooperatives are having problems. If the Farm Credit System is forced to

CHARGE HIGHER INTEREST RATES, FREEZE STOCK OR INCREASE FORECLOSURE RATES, THEN EVERYONE IS IMPACTED. THE FARMER IS NOT ONLY IMPACTED IN HIS OWN FINANCIAL ARRANGEMENTS BUT IN HIS REDUCED BENEFITS OR EARNINGS AS A MEMBER OF THE COOPERATIVE. HIGHER INTEREST RATES WOULD NOT ONLY INCREASE THE FARMERS' INTEREST EXPENSE, BUT ALSO REDUCE HIS EARNINGS FROM THE COOPERATIVES BECAUSE OF THE HIGHER INTEREST CHARGES. THE FARMER IS PAYING TWICE.

THESE ARE DIFFICULT TIMES FOR FARMERS AND THEIR COOPERATIVES. FEW SECTORS OF THE ECONOMY HAVE EXPERIENCED SUCH A RAPID REVERSAL IN ECONOMIC FORTUNES AS HAS OCCURRED IN AGRICULTURE IN THE 1980's.

BUT THE IMPACTS ARE NOT CONFINED ONLY TO FARMERS OR THEIR COOPERATIVES. AMONG THE INPUT INDUSTRIES, WE FIND FARM MACHINERY PLANT OPERATIONS SCALED BACK TO LESS THAN HALF OF CAPACITY. THE FERTILIZER INDUSTRY IS USING LESS THAN THREE-FOURTH'S OF ITS CAPACITY AND THE TRANSPORTATION, PROCESSING AND MARKETING SECTORS HAVE ABOUT ONE-FIFTH OF THEIR CAPACITY UNUSED. THIS REPRESENTS LOST JOBS AND INCOME TO THE LOCAL COMMUNITIES THAT MAKE UP RURAL AMERICA.

THERE ARE A NUMBER OF COMPLICATED AND RELATED FACTORS WHICH HAVE CONTRIBUTED TO THE CURRENT STATE OF AGRICULTURE -- INCLUDING ECONOMIC RECESSION, AN OVERVALUED DOLLAR, THIRD WORLD DEBT, UNFAIR TRADE PRACTICES, AND PAST EMBARGOES. BUT THE ISSUE IS WHERE DO WE GO FROM HERE?

I BELIEVE WE ARE MAKING PROGRESS. I WISH TO COMMEND THIS COMMITTEE AND THE HOUSE OF REPRESENTATIVES FOR ITS APPROVAL OF A 1985 FARM BILL. THIS I BELIEVE RECOGNIZES THE CURRENT PROBLEMS OF AGRICULTURE AND ATTEMPTS TO PROVIDE THE SUPPORT NECESSARY TO RETURN PROFITABILITY TO FARMING.

THIS MEASURE IS DESIGNED TO STABILIZE THE DROP IN FARM INCOME AND, HOPEFULLY, LAY THE FOUNDATION FOR FUTURE RECOVERY IN TERMS OF EXPORT MARKETS AND FARM INCOME. HOWEVER, IN THE NEAR TERM WE MUST RECOGNIZE THE FACT THAT AGRICULTURE IS EXPERIENCING A MASSIVE DECAPITALIZATION. THIS, IN TURN, IS UNDERMINING INCOME STABILIZATION EFFORTS AND THE VIABILITY OF THE AGRICULTURAL LENDING INSTITUTIONS. THIS LEADS TO A FURTHER DETERIORATION IN THE FINANCIAL CONDITION OF AGRICULTURE.

THE NEXT 12-24 MONTHS WILL BE INCREASINGLY DIFFICULT FOR FARMERS AND THOSE PROVIDING FINANCING. IF LAND VALUES CONTINUE TO DECLINE OR FALL SHARPLY -- THE EQUITY OF OTHERWISE SOUND FARM OPERATORS WILL BE GREATLY REDUCED. THIS COULD LEAD TO AN INCREASE IN THE SIZE OF LOAN WRITE-OFFS AND THE MAGNITUDE OF THE FINANCIAL PROBLEM. THEREFORE IT IS ESSENTIAL TO RESTORE STABILITY TO FARMLAND VALUES AND ASSURE CREDIT AVAILABILITY TO AMERICAN AGRICULTURE AT REASONABLE RATES.

THE FARM CREDIT SYSTEM, DEDICATED EXCLUSIVELY TO AN INDUSTRY THAT IS FACING CONTINUED EROSION IN REAL INCOME AND MASSIVE ASSET DEVALUATION, CANNOT CONTINUE TO ABSORB THE FINANCIAL CONSEQUENCES. THE SYSTEM HOLDS ABOUT ONE-THIRD OF THE TOTAL FARM DEBT AND 48 PERCENT OF THE FARM REAL ESTATE DEBT. INCREASING INTEREST RATES TO GENERATE EARNINGS IN THE FACE OF MOUNTING LOSSES WILL DRIVE FARMERS WHO ARE CURRENTLY TRYING TO REFINANCE TOWARD BANKRUPTCY AT AN ACCELERATING RATE. FOR THOSE WHO CAN REFINANCE, THESE SAME HIGHER RATES ARE DRIVING THOSE FARMERS TO OTHER LENDERS. OTHER FARMER CAPITAL FLEES THE SYSTEM OUT OF FEAR THAT THEIR STOCK INVESTMENT WILL BE LOST. THE RESULT IS A DOWNWARD SPIRAL IN THE CONFIDENCE AND CAPITAL BASE IN THE SYSTEM AS A WHOLE. THIS IS TRUE NOT ONLY FOR FARMERS BUT THEIR COOPERATIVES WHO DEPEND ON THE SYSTEM AS A VITAL SOURCE OF CREDIT.

THE NATIONAL COUNCIL OF FARMER COOPERATIVES SUPPORTS THE PROPOSAL OF THE FARM CREDIT SYSTEM AND VIEWS IT AS AN INTEGRAL COMPONENT OF A COMPREHENSIVE AND BALANCED APPROACH TO RESTORING PROFITABILITY TO AGRICULTURE. WE LOOK FORWARD TO WORKING WITH YOU, MR. CHAIRMAN, AND THE COMMITTEE IN A CONTINUED EFFORT TO ADDRESS THE VERY REAL PROBLEMS CONFRONTING AGRICULTURE.

THANK YOU MR. CHAIRMAN.

nmpf

national milk producers federation

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James C. Barr, CAE
Chief Executive Officer

Before the

SUBCOMMITTEE ON CONSERVATION, CREDIT
AND RURAL DEVELOPMENT

of the

COMMITTEE ON AGRICULTURE
UNITED STATES HOUSE OF REPRESENTATIVES

With Regard to

The Farm Credit System

Norman H. Barker
Route 1
Pratt, Kansas 67124
(316) 672-6735

President
National Milk Producers Federation

The National Milk Producers Federation is a national farm commodity organization representing virtually all of the dairy farmer cooperatives and their dairy farmer members who serve this nation by producing and marketing milk in every state in the Union.

Since its inception in 1916, the Federation has actively participated in the development of dairy programs which are a part of a total system of agricultural law and policy which can appropriately be termed a national food policy.

The policies of the Federation are determined by its membership on a basis that assures participation from across the nation. The policy positions expressed by NMPF are thus the only nationwide expression of dairy farmers and their cooperatives on national public policy.

Mr. Chairman, I am Norman H. Barker, President of National Milk Producers Federation and a dairy farmer from Pratt, Kansas. I commend you for conducting these hearings on a critical issue--the financial future of the Farm Credit System.

THE FEDERATION

The National Milk Producers Federation is the national farm commodity organization representing dairy cooperative marketing associations owned and operated by dairy farmers throughout the nation. Most of the nation's milk supply is marketed through the cooperative associations represented by the Federation. Organized in 1916, the Federation is the oldest and largest farm commodity organization in the United States and the only organization whose policy represents a national consensus of dairy farmers.

Most of you, of course, are familiar with the Federation largely in conjunction with our work on dairy issues.

I am here today, however, because the availability of credit has always been critical to the agriculture industry regardless of the commodity from which farmers earn their livelihood.

There are many sources through which producers secure credit--including commercial banks, insurance companies, family financing, direct federal assistance through the Farmers Home Administration, as well as the Farm Credit System. In my view, in light of the tremendous economic instability throughout this varied agricultural finance system, comprehensive measures to address these problems will, in the final analysis, be necessary. But obviously, many of these questions go beyond the jurisdiction of this subcommittee. Thus, in the interest of providing members of the subcommittee with our views on the Farm Credit System and its current condition, I will focus my comments on the FCS.

THE FARM CREDIT SYSTEM

I am here to urge this Subcommittee to move forward on legislation which would give direct assistance to the Farm Credit System and which would allow the System to maintain its independence with stronger FCA regulation and oversight. I take this position for several reasons.

First, I think we all agree that there are two central issues facing American farmers: one is farm income and profitability; and two is the availability of credit and at an affordable rate.

It is quite obvious, of course, that if we had adequate income, there would not be as much of a compelling need to discuss the credit issue. The 1985 Farm Bill as approved by the House of Representatives can help address the income side, but the reality is we have a credit crunch that must be addressed. Since the Farm Credit System has been a primary source of credit and equity for producers, it is imperative that actions be taken to insure that it can deliver credit to farmers at a competitive rate of interest and that the producer-owners' equity be protected as best as possible to avoid further deterioration in their net worth.

Second, although we've heard it said numerous times during this debate, it is important to reiterate: the Farm Credit System was founded to provide credit to farmers and their cooperatives when no other lending institutions would assume the risk during the Depression. Given that historical mission and the fact that the System has carried out that mission, it is not surprising that it is facing this financial crisis, just as its owner-patrons are facing individual financial crises.

There can be no dispute that the System has faithfully and effectively carried out its mission for the past fifty years as a cooperative, member-owned entity. The record also demonstrates that this cooperatively-owned system repaid the federal government's initial investment and has operated in a financially responsible manner over the past fifty years.

Clearly, the troubles now being experienced by the Farm Credit System and American agriculture as a whole, are the result of erroneous actions taken by the federal government starting with the fence-row to fence-row agriculture policies of the late 1960's and early 1970's, to the exportation of farm technology that succeeded in taking away markets, to the current level of deficit spending that has created high interest rates and a strong U.S. dollar that handicaps exporting to the markets that remain. Finally, although no one wants to complain about low inflation, its flip side--deflation and depreciation of land values, has proved to be the final straw to an industry so vitally dependent on land for its livelihood.

The accumulated effect of these federal policies has been to create an agricultural credit crisis last approached during the Depression. The magnitude of this crisis is so great that I believe the federal government must come forth and assist the System, and in turn, agricultural producers. I firmly believe that the Farm Credit System and agriculture have been buffeted by circumstances beyond their control and ought to have an opportunity to "re-tool" or adjust to these dramatically different circumstances just as other industries have been provided federal relief through various federal actions.

Finally, in examining the precedents for federal assistance to distressed institutions--Lockheed in 1971, Franklin National Bank in 1973, New York City in 1975, Chrysler in 1977 and most recently, Continental Bank--in all cases these institutions were given federal assistance and allowed to remain independent. When one further examines these precedents, one must also note that in all cases these "bailouts" were necessary due largely to bad management unlike, in my opinion, the farm credit crisis which is in large part due to the policies I mentioned earlier. Nonetheless, federal assistance proved wise and resulted in re-tooled and viable institutions.

I urge this Subcommittee to move forward and support legislation that would allow the Farm Credit System to remain solvent and independent with some stronger FCA control. Federal assistance, in my opinion, could come in one, or a combination of, several ways:

- A direct cash infusion of capital from the Federal government through long-term, no- or low-interest loans;
- Federal government loan guarantees to ensure access to capital markets;
- Federal assurances that debt obligations of the system shall remain a quality investment.

Those concerned about precedents should note that the Federal National Mortgage Association, which is a federally-chartered but privately-owned institution, has a multi-billion dollar potential drawing power with the U.S. Treasury.

The most direct assistance and the avenue which offers the most immediate results would be for the federal government to make a direct cash infusion into the system. Critics argue that this would set a bad precedent and undermine the independence of the system.

To those who would make this charge, I would respond that the federal government, on a daily basis, retains billions of dollars in cash balance accounts throughout our commercial banking system and no one has suggested that this has eroded the independent nature of those institutions.

A direct loan, however, may not be sufficient so we therefore urge Congress to provide additional loan guarantees for the system and maintain a stable market for obligations both presently outstanding and in the future. This can be done either by extending to those debt instruments the full faith and credit of the U.S. government or for the government to engage in the direct purchase of that debt.

To sum up, the farm credit crisis is real and it is an immediate problem. It is an issue which cannot be put off. It must be addressed on the basis of maintaining stability throughout our entire domestic financial system and providing relief to producers. As I indicated earlier, we believe that the historical success of the system provides economic justification of the federal government to provide a needed helping hand to alleviate the current crisis.

Mr. Chairman, I would like to commend you and other members of the Subcommittee for holding this hearing. We in agriculture are facing a difficult period in economic history and the linchpin of our surviving this crisis hinges on our ability to assure a continued source of adequate and affordable credit for our farm community.

Thank you for this opportunity to testify.

Statement of Irvin J. Elkin

President
Associated Milk Producers, Inc.

My name is Irvin J. Elkin. Along with my family, I milk about 40 Holstein cows and farm 200 acres of corn, alfalfa and small grains in Amery, Wisconsin.

I am President of Associated Milk Producers, Inc. the nation's largest dairy farmer cooperative with over 31,000 members located in 20 states throughout the midwest, south and southwest, who produce about 11 percent of the nation's milk supply. I also have the honor to serve on the Executive Committee of the National Milk Producers Federation and as a member of the National Commission on Agricultural Trade and Export Policy.

We appreciate the opportunity to testify today. Recognizing that others have already covered the farm credit problem from virtually every conceivable perspective, I'm going to keep my comments very brief.

First and foremost, we want to emphasize that the current credit crisis is a sympton of the agricultural condition, not the cause. The best and only truly effective way to alleviate the credit situation is through improving farm income.

We have repeatedly maintained that improvement of farm income must be the number one priority in constructing responsible programs for the 1985 Farm Bill and future national agricultural policy. America's farm families cannot be allowed to endure the kind of dismal returns that have unfortunately characterized recent years.

Adequate credit is an essential tool for today's progressive agriculture, and a healthy Farm Credit System is essential to the farm economy. It is evident that federal help in some form is essential to meet current problems. The debate is not "if" but "how". Moving to specifics, we'd like to share the following thoughts:

1) Federal help for the Farm Credit System must come quickly to provide the necessary support before internal reserves are exhausted and the elements of the System are too weak to do their jobs.

2) Any assistance must emphasize helping farmers, not just institutions.

3) Finally, the assistance must be fair and equitable and avoid aiding one group or type of farmers at the expense of another.

In the interest of time, I've kept my comments to a minimum. We do not mean to gloss over the seriousness of the problem or the urgency of taking action. We applaud Chairman Jones and the subcommittee for addressing this issue, and look forward to the development of a workable solution that will help correct the problem.

In closing, let us reiterate that the surest way to protect the Farm Credit System is the adoption of sound farm programs that will increase farm income. Farmers earning a fair return on their investment is the simplest and most viable answer to the farm credit crisis.

Financial Conditions in Agriculture:
The Agricutural Credit Crisis

Testimony of

Derryl McLaren

on Behalf of the

NATIONAL CORN GROWERS ASSOCIATION

NATIONAL ASSOCIATION OF WHEAT GROWERS

NATIONAL COTTON COUNCIL

NATIONAL CATTLEMEN'S ASSOCIATION

NATIONAL GRANGE

NATIONAL WOOL GROWERS ASSOCIATION

before the
Subcommittee on Conservation, Credit and Rural Development

Chairman Ed Jones

October 31, 1985

Mr. Chairman, my name is Derryl McLaren. I am a farmer from Farragut, Iowa, and I produce corn, soybeans and hogs. I am also a Federal Land Bank stockholder in the Omaha Farm Credit District.

I am here on behalf of several agricultural organizations that are extremely concerned over the financial state of agriculture, and the viability of the lending institutions serving agriculture. Our members are the agricultural families who account for the greatest part of agricultural production in the United States. Our members are the borrowers from the commercial banks, the Farm Credit System and the trade creditors--we must bear the consequences of any plan to resolve the credit problem..

A reasonable question for you to ask is first, why we are concerned, and second, why should Congress and the taxpayers and consumers of the U.S. be concerned about the agricultural financial crisis? A brief look at the statistics on the financial crisis in American agriculture provides reason enough for concern. We have reviewed several economic analyses of the problem, including some prepared by the USDA, and we find the information frightening. This problem is larger than most of us care to contemplate.

The absolute level of agricultural debt is large at $210 billion. The share that is at risk is significant--just under 25 percent of total debt. Recent economic studies indicate that up to $50 billion in agricultural credit may be unserviceable given present economic conditions in agriculture. In fact, much of this debt may be unserviceable under even the best of economic conditions that might be realistically expected.

Trying to handle this much "at risk" debt does more than financially strain a few farmers. This unsustainable debt also puts lending institutions, local communities, and agribusiness concerns at risk. The loss of jobs and disruption of communities, which is now significant in many parts of the country, is forcing a tremendous and tragic change on rural America.

The data in the attached tables show where the problem is and who holds the debt. We think this information is a shocking statement on how severe the agricultural financial situation is at present.

It is particularly instructive to look, in Table 1, at which lenders hold the 'bad debt' or the debt "at risk" of full or partial loss. It is not, contrary to popular opinion, confined to a certain segment--the credit problem extends to all sectors of lending and all areas of agricultural production.)

Debt concentration by type of farming operation is shown in Table 2. One conclusion that can be drawn from this table is that the commercial producers--the full-time family farmers and ranchers that account for over 70 percent of agricultural production--are hardest hit by the present financial stress.

Debt concentration by region can be seen in Table 3. While some areas of the country appear to be harder hit, no area is unhurt. This problem exists throughout the U.S.

The problem exists for all sectors of agricultural production and lending, As a result, Congress cannot afford to focus on one sector to the exclusion of the others, nor can it focus on one region to the exclusion of others. Any kind of relief package must account for borrowers, and for the different kinds of lenders, throughout the country.

As agricultural organizations representing the producer/borrowers, we have been meeting to discuss the criteria which we think are appropriate to evaluate the various credit proposals that will be considered. We are also working on a credit relief package that the agricultural groups can accept and support. Any package so developed will meet the criteria we are about to outline. We expect to have a proposal for your consideration within the next few weeks.

We urge you to also consider these criteria as you address the credit problem. The focus of the criteria is on establishing an agricultural credit relief proposal that is helpful and acceptable to agricultural producers. The criteria are general, but succinct.

Any solution must focus on the agricultural producers who are under financial stress, but who may survive with some assistance. Those who can survive must be helped, but not through more credit; instead, they need help to handle existing debt. Any legislation must be targeted toward maintaining the financial viability of these farming operations. Debt reduction, interest rate relief and financial counseling will help many of these producers.

Some form of transitional assistance should be considered to help those whose debts are greater than can realistically be repaid from their farming operations, and who must leave agriculture. This transitional assistance may also be the least cost and best means of easing the pain of the restructuring that is presently underway.

High interest rates on agricultural loans must be reduced. Interest rates charged agricultural producers currently range from about 3 to as much as 6 points above rates paid by other industries. Part of this may be due to inherently great risk in agriculture, but part of the difference may be symptomatic of structural problems in agricultural lending.

When viewed on a comparable cost basis, interest rates for agricultural production are substantially higher than long term rates of return on agricultural assets. This suggests continued erosion in farm asset values.

Agriculture cannot return to financial health until interest rates are more in line with with rates of return from the industry.

The farm bill is a necessary part of the solution, but is not a sufficient vehicle to resolve the problem. An understandable sentiment in Congress is to try to address credit through the Farm Bill. However, this is at best only a partial answer. The Farm Bill serves as a guide and risk management tool for some producers, but cannot begin to reach all segments of agriculture.

Farm programs can help maintain net farm income (at $20 - 25 billion). However, the federal farm programs only directly affect about 45 to 50 percent of all agricultural production. As outlined earlier, the credit problem affects all agricultural producers. It is not especially size or region specific--all producers are hurting.

Losses are occurring, will continue to occur and must be shared by all participants in agricultural credit: taxpayers, borrowers, shareholders, lenders, stockholders, etc. No one segment can withstand the losses that must be taken. Some means of equitably spreading this loss across the broad economy must be considered. We do not support a bailout for any segment either; we will all bear our share of the loss. We believe, however, that forcing too much of the loss on one group may create distortions in the general economy.

We cannot afford the demise of a sector forced to assume too much loss. For example, one source of jobs in rural communities is agribusiness concerns that service commercial agriculture. Forcing these firms out of business will only compound the problem for local communities trying to adjust and absorb the financial losses. Some attrition will be inevitable, but we need to avoid a domino effect.

A viable means for delivering credit to agriculture is important and must be maintained. This may mean a re-structuring of present agricultural credit institutions and relationships, but the result must accommodate the unique biological and cyclical nature of agriculture. This area is the most important, and cannot be forgotten in an attempt to handle the immediate problem. We encourage efforts to maintain present structures, and forgo abrupt structural changes until the financial viability of the agricultural credit sector is established.

Mechanisms to prevent this financial crisis from occurring again. Preventing this from occurring again is a difficult task, but we must try whatever steps possible to prevent it. We do not have an answer, but it appears to us that oversight and regulation must be improved, both for commercial banks and for the Farm Credit System. The only real long term prevention is, of course, to for agriculture to be profitable.

In conclusion, we urge you to recognize that the problem is massive, it cannot be looked at as a problem of only lending segment, and will require coordinated effort on a package of alternatives to be successful. The Agriculture Committees have the opportunity to take a leadership role in developing the package. We urge and hope that you will take a broad view of the problem, and the solutions that will be required.

(Tables follow:)

Table 1: Agricultural Debt, and Agricultural Debt "At Risk"

Source	Total debt (bil $)	Estimated At Risk (bil $)
Farm Credit System	$ 70.0	$ 2 - 11
Commercial Banks	56.0	1.5 - 4
Farmer's Home Admin.	26.0	13 - 15
Insurance Companies	12.0	.5 - 2
Trade Credit	18.0	7 - 10
Individuals	28.0	4 - 8
Totals	$ 210.0	28 - 50

Source: The numbers are based upon USDA data, recent economic analyses and the published statements of the various lending institutions. These are not numbers generated by the agricultural groups; These are the range of estimates offered by lenders within the past few months.

Table 2: DEBT CONCENTRATION BY FARMING OPERATION

	TYPE			
	CROPS	BEEF	PORK	DAIRY
	D/A	D/A	D/A	D/A
GROSS SALES CLASS				
Less than 10,000	18.93	10.85	16.61	22.85
10,000 - 24,999	16.50	9.22	37.27	12.45
25,000 - 49,000	30.21	17.15	30.51	41.64
50,000 - 99,999	43.04	30.27	39.36	24.07
100,000 - 249,999	41.95	28.36	61.56	22.20
250,000 - 499,999	50.48	45.44	60.60	34.32
500,000 and over	32.40	44.32	36.16	33.36
All	36.07	19.45	47.56	25.58

*CROP PRODUCERS INDICATE GREATEST FINANCIAL STRESS IN MID RANGE FARMS FROM $50 TO $500 THOUSAND IN GROSS SALES.

*BEEF PRODUCERS HAVE LOWEST TOTAL DEBT TO ASSET BUT LARGER PRODUCERS, ABOVE $250 THOUSAND, INDICATE FINANCIAL PRESSURE.

*PORK PRODUCERS CARRY HIGHEST DEBT/ASSETS WITH TWO CLASSES IN THE HIGH STRESS CATEGORY, $100 TO $500 THOUSAND GROSS SALES.

*SMALL DIARY FARMS, $25 TO $50 THOUSAND INDICATE HEAVY FINANCIAL STRESS.

SOURCE: Farm Journal survey; December 1, 1984, and the Food and Agricultural Policy Research Institute (FAPRI).

NOTE: "Type" of operation based on percent of gross sales. For example, an operation was called a "CROP" farm if 70 percent of sales came from crop sales. For Beef and Dairy, 50 percent was used, and 30 percent for Pork.

Table 3: DEBT CONCENTRATION BY FARM SIZE

	REGION				WEIGHTED NATIONAL AVERAGE
	EAST	SOUTH	CENTRAL	WEST	
	D/A	D/A	D/A	D/A	D/A
GROSS SALES CLASS					
Less than 10,000	13.78	13.07	15.57	15.53	13.93
10,000 - 24,999	9.14	7.97	23.60	21.18	15.02
25,000 - 49,000	11.96	28.43	29.44	27.70	27.88
50,000 - 99,999	25.87	43.17	39.07	26.43	37.76
100,000 - 249,999	23.56	38.01	43.42	25.73	38.52
250,000 - 499,999	41.26	33.48	54.03	41.49	48.41
500,000 and over	13.64	22.93	43.45	43.15	35.19
All	20.85	25.30	38.37	28.32	31.80

*EAST HAS LOWEST DEBT/ASSET RATIO WITH HEAVIEST FINANCIAL STRESS IN $250 TO $500 THOUSAND.

*SOUTH INDICATES HIGHEST FINANCIAL STRESS IN $50 TO $100 THOUSAND.

*CENTRAL RELECTS HEAVIEST CONCENTRATION OF FINANCIAL PRESSURE STARTING AT $100 THOUSAND AND ABOVE.

*WEST INCIDATES GREATEST FINANCIAL STRESS IN FARMS ABOVE $250 THOUSAND.

SOURCE: See Table 2.

A FAIR CREDIT PLAN TO SAVE THE LENDERS AND THE FARMERS

Statement to the Subcommittee on Conservation, Credit and Rural Development of the Committee on Agriculture, U.S. House of Representatives, October 31, 1985

Dr. Barry M. Casper
Director, Crisis in Agriculture Project
Program in Science, Technology and Public Policy
Carleton College Northfield, Minnesota 55057

Mr. Chairman and Members of the Subcommittee:

I am pleased that Congress is preparing to respond to the financial crisis in American agriculture. You have heard emergency credit plans advanced by the Farm Credit System and the other lenders. These would establish one or more "loan warehouses," quasi-private corporations that would use government funds to buy up bad loans from the agricultural lenders. But this approach could result in bailing out one of the two groups in trouble, the lenders, while, in the process, creating conditions whereby the other group in trouble, family farmers, would lose their farms.

You should know that there is an alternative, the Fair Credit Plan, that would involve a comparable outlay of taxpayers' money and keep both lenders and farmers in business.

What the plans have in common is that agricultural lenders are rescued by reducing the anticipated disasterous losses they would suffer and the precipitous decline of farmland and farm equipment prices is blunted by reducing the anticipated glut of available land and equipment. Where they differ is in what happens to the farmers in trouble and in who will decide their fate.

They also differ in that the Fair Credit Plan explicitly makes the connection between the credit crisis and its underlying cause--the current unprofitability of agriculture. The annual cost of this plan would be reduced dramatically with even modest increases in farm commodity prices.

This is a crisis of historic dimensions. All farmers are suffering from a precipitous decline in farmland values. And commodity prices are so low and interest rates so high that many farmers are unable to make their full loan payments. For these reasons, more than one-third of the nation's 700,000 commercial family farmers now have debts that are effectively out of control.

Agricultural lenders are now faced with a choice between two unattractive alternatives. Because of the depressed land and equipment markets, the amount lenders can anticipate receiving if they foreclose is much less than the loan amount. Thus, they can carry many farm borrowers who are unable to maintain full loan payments and lose money, or they can foreclose and, in many cases, lose even more money.

The lenders have proposed that the government finance quasi-private corporations that they will control. Those corporations would offer to buy from the lenders the loans of farmers in trouble. The lenders would lose some money in these transactions, but the losses would be held to an acceptable level. In this way, the lenders' crisis would be averted.

But what about the farmers? In this approach, the warehouse would have the option of foreclosing on the loans, holding the land it acquires off the market for a time, thereby stabilizing land values, and then profitting when land values rise again.

This was precisely the theory of the Farm Credit System's original bailout proposal last spring. The plan was to establish another quasi-private corporation, the Agricultural Conservation Corporation (ACC), that would offer to buy up farmland at a price well above what lenders can expect to receive if they foreclose.

This would extricate lenders from their bind. They could afford to foreclose, because they would be acquiring land that would have an immediate buyer at a good price. They might not be able to recoup the full debt, but their losses would be reduced to acceptable levels. The ACC would hold the land off the market for a while and profit when land prices went up.

But the ACC plan obviously would not help farmers in trouble. In fact, it would provide an invitation to agricultural lenders to cut their losses and foreclose. This would set in motion a rash of foreclosures. And those who would eventually buy the land from the ACC would most likely be the very large farms that are not in trouble and corporations or wealthy individuals seeking tax shelters.

Because its disasterous impact on family farms was so transparent, the ACC proposal ran into a storm of criticism in the agricultural states. It has now been replaced by the "loan warehouse" plan. It should be noted, however, that if the loan warehouse adopts a policy of foreclosing on the loans it acquires, the new approach will have the same outcomes for lenders, farmers and the government as the ACC.

In evaluating the lenders' proposals, this is what you must examine critically. Every loan warehouse plan has a crucial decision point at which the financial condition of a farmer in trouble is subjected to the ultimate test: If the farmer's loan were restructured in a certain way, which varies depending on the proposal, would he be able to cash-flow? If the answer is yes, the loan is restructured. If the answer is no, the farmer is foreclosed.

You must look very closely at the implications of the particular tests proposed. The analyses my students and I have performed suggest that, whatever the warehouse plan, for a majority of the farmers in trouble, the warehouse's answer will be NO and the farmer will be foreclosed.

It is not difficult to understand why when you realize what a difficult time farmers are having in making ends meet with today's commodity prices. For example, the latest USDA figures show that half of the farmers in trouble with gross sales of $40,000 to $100,000 (typical mid-sized family farms) have no cash whatsoever left over for loan payments or rent after they pay their farm operating expenses and family living expenses.

In short, the proposed warehouse would transfer the decisions far way from local lenders, who are aware of and more likely to be sensitive to their rural community's concerns and interests, and establish decision guidelines whereby many of the commercial family farmers in trouble will lose their farms. The net result will be a rash of foreclosures and a massive transfer of American farmland, with a dramatic increase in the concentration of farmland ownership and in the number of absentee-owned tenant farms.

Now consider an alternative, which we call the Fair Credit Plan. Affirming a renewed national commitment to supporting family-sized, owner-operated farms, federal and state emergency legislation would establish a new partnership aimed at helping family farmers and agricultural lenders survive this crisis.

Under this plan, administered by the states, with local mediation boards, lending institutions would write down a farmer's debt, and the government would pay enough to further reduce the debt to a level at which the farmer could afford to make payments. The lender would lose some money in writing down the loan, but not nearly as much as the loss he would take if he foreclosed under the present circumstances. In this sense, the outcome for lenders would be much the same as under the lenders' proposals.

But for the farmer in trouble, the outcome would be much more just. The farmer would end up with a manageable loan payment and he would stay in business. Of course, the farmer would now owe the government the amount the government paid the lender.

Farmers not in trouble would benefit as well. By preventing many farm foreclosures, this plan would stabilize land and equipment markets, stemming the slide of prices that is reducing the assets of all farmers.

For the public, the benefits would include saving agricultural lenders from financial disaster and keeping on the land the experience and expertise of the family farmer. This, in turn, would benefit rural communities, whose viability is linked to the survival of both lenders and family farms. Government costs would mainly come from deferring the farmers' repayment of the money the government pays the lenders.

The rate at which a farmer would repay the government would depend on the rate at which the farmer's cash flow situation improved, which, in turn, would depend on the rate at which farm commodity prices increased. In this way, the government would acquire a direct and highly visible stake in the profitability of American agriculture.

Our analyses show that the first-year government costs of the Fair Credit Plan and the loan warehouse approach are comparable if the same lender writedown and interest rates are assumed. After that, the Fair Credit Plan cost depends on what happens to commodity prices. An increase in prices to a point where corn is $3.50 instead of $2.50 a bushel, for example, would reduce the second-year government outlay to about one-third the first-year value.

An alternative mode of repayment, available to those farms that got in trouble by expanding when land prices were nearing their peak, would be to turn over the expansion acres to a government-administered beginning farmer program. In constrast to the lenders' plan, much less farmland would be transferred and what land the government did acquire would be directed to beginning farmers at an affordable price.

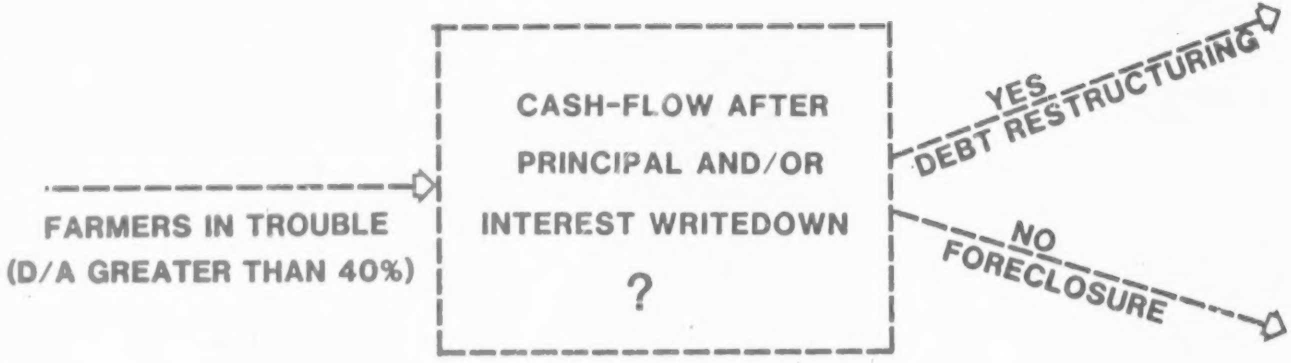
A final important feature of this plan is land stewardship. The arrangements the government would be making with many practicing farm families and many beginning farm families offer an unparalleled opportunity to introduce land stewardship obligations.

In conclusion, this must be understood as a critical moment in the history of U.S. agriculture and rural America. In the coming months, our agricultural structure and our rural culture could be precipitously and irrevocably altered, to the detriment of our entire society.

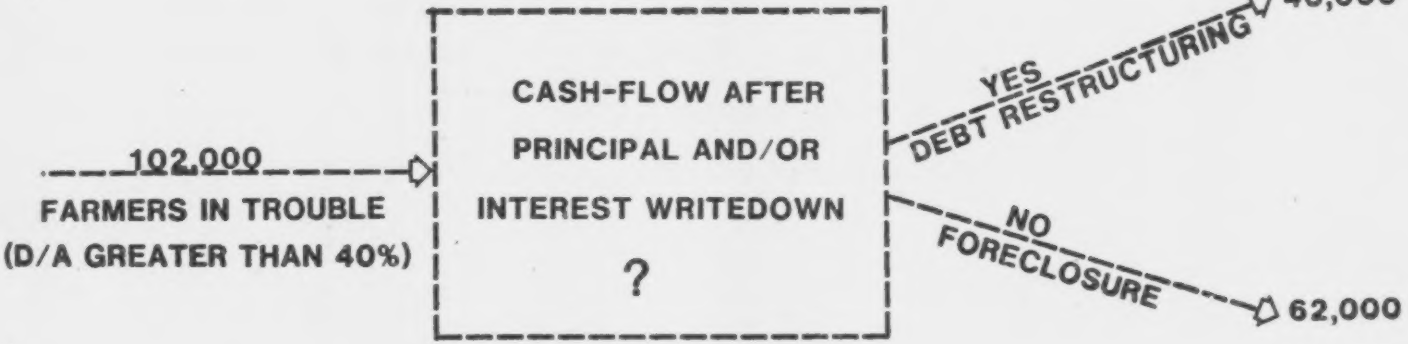
A key issue as Congress addresses alternative policies is public accountability. It would be a grave mistake to transfer government funds to the lenders in trouble and tell them to use their best judgment in choosing between foreclosure and family farms. It is in the public interest to make sure the public funds we invest will be used to save both agricultural lenders and family farmers, and thus rural America, from financial ruin.

(Attachments follow:)

LOAN WAREHOUSE


FARMERS IN TROUBLE
(D/A GREATER THAN 40%)
CASH-FLOW AFTER
PRINCIPAL AND/OR
INTEREST WRITEDOWN
?
YES
DEBT RESTRUCTURING
NO
FORECLOSURE

LOAN WAREHOUSE EXAMPLE



102,000

FARMERS IN TROUBLE
(D/A GREATER THAN 40%)

CASH-FLOW AFTER
PRINCIPAL AND/OR
INTEREST WRITEDOWN
?

YES
DEBT RESTRUCTURING

40,000

NO
FORECLOSURE

62,000

COMMERCIAL FARMS WITH
40,000-100,000 IN GROSS SALES

30% PRINCIPAL WRITEDOWN
10% INTEREST RATE

USDA's LATEST FIGURES

One-half of the farms in trouble with gross sales between $40,000 and $100,000 have no cash for loan payments or rent.

REASON: Low Commodity Prices

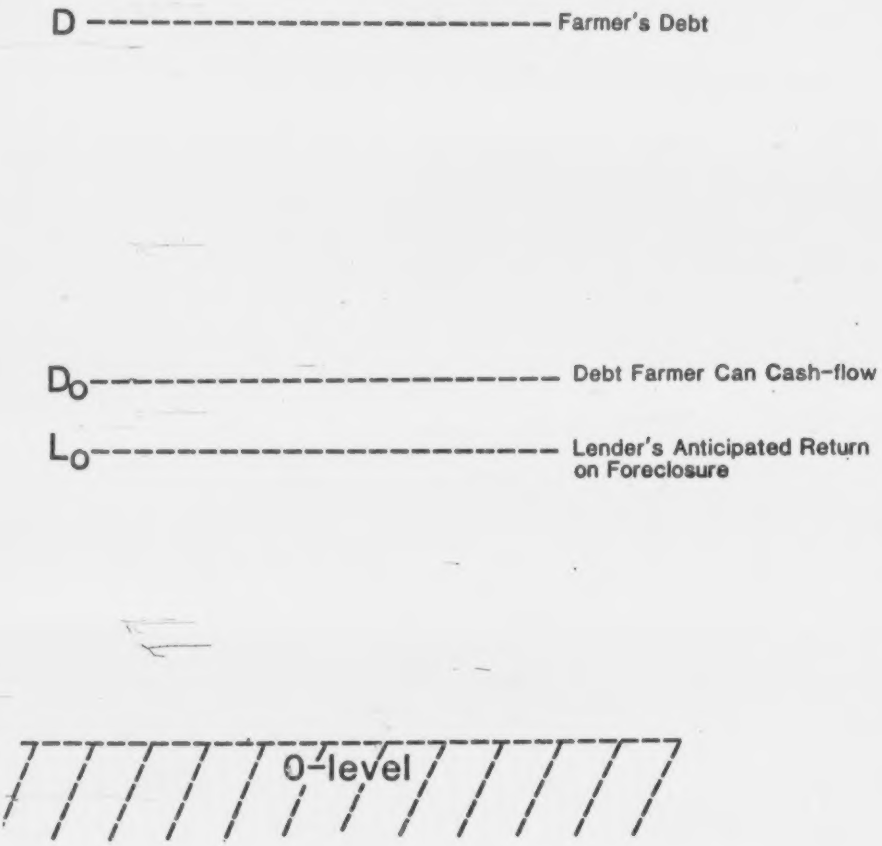
4

LOAN WAREHOUSE OUTCOMES

- ○ Lenders Rescued
- ○ Decision-making Far Removed
- ○ Many Farm Foreclosures
- ○ Massive Transfer of Farmland

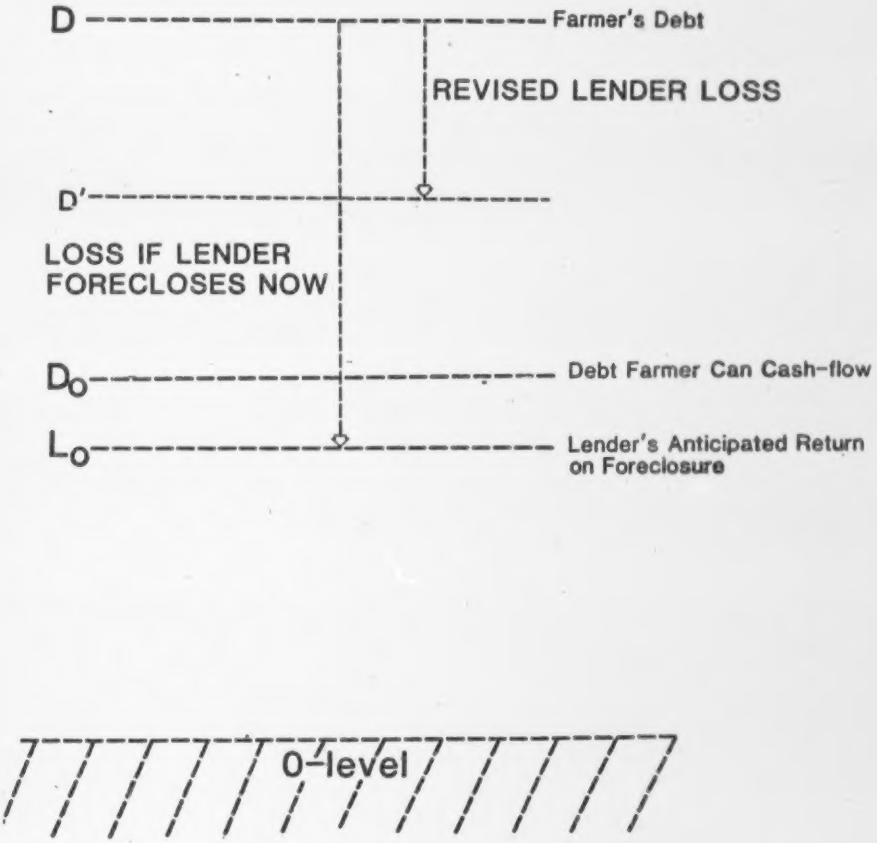
"THE FARM CREDIT PROBLEM"

Viewpoints of a Typical Farmer in Trouble and his Lender


D
Farmer's Debt
D_0
Debt Farmer Can Cash-flow
L_0
Lender's Anticipated Return on Foreclosure
0-level

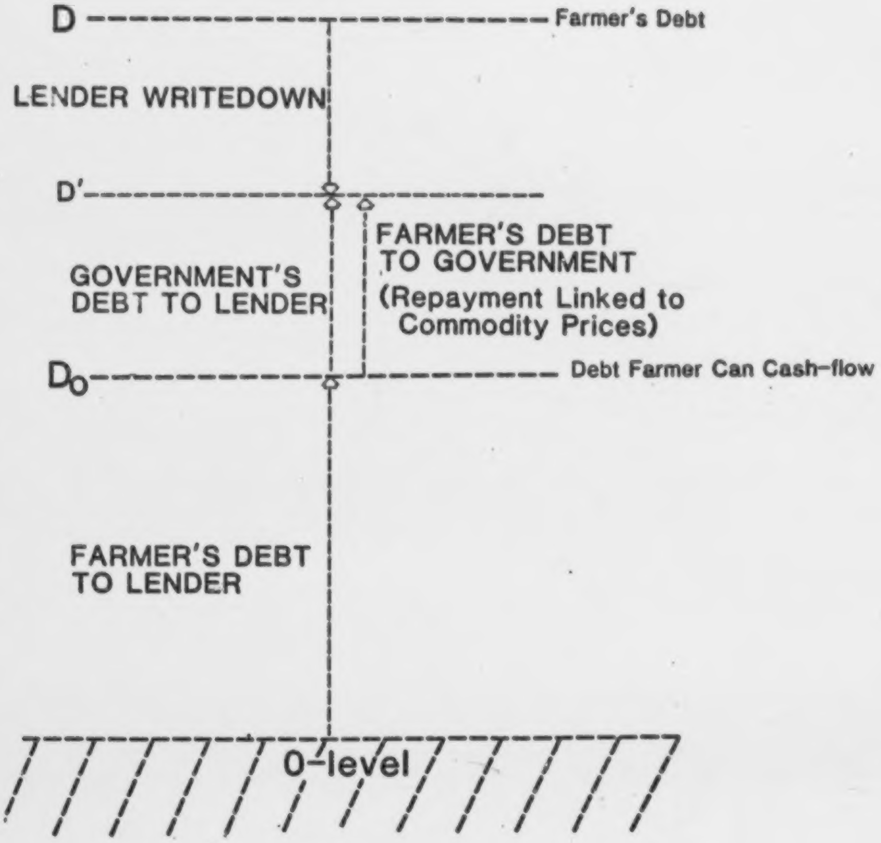
CREDIT PROPOSALS HAVE A COMMON FEATURE:

Lender Losses Are Reduced to Acceptable Level
(But Lenders Do Take Some Loss)


D
Farmer's Debt
REVISED LENDER LOSS
D'
LOSS IF LENDER FORECLOSES NOW
D_0
Debt Farmer Can Cash-flow
L_0
Lender's Anticipated Return on Foreclosure
0-level

PROPOSALS DIFFER IN OUTCOME FOR FARMERS

FAIR CREDIT PLAN


D
Farmer's Debt
LENDER WRITEDOWN
D'
GOVERNMENT'S DEBT TO LENDER
FARMER'S DEBT TO GOVERNMENT
(Repayment Linked to Commodity Prices)
D_0
Debt Farmer Can Cash-flow
FARMER'S DEBT TO LENDER
0-level

1. LENDER'S LOAN NOW "GOOD"
2. GOVT. ACQUIRES LOAN OR LAND FOR BEGINNING FARMER PROGRAM
3. FARMER KEEPS FARM

8

FAIR CREDIT OUTCOMES

- ○ Lenders Rescued
- ○ Decision-making in Community
- ○ Farmers Keep Farms
- ○ Much Less Farmland Transfer & to Beginning Farmers
- ○ Government Acquires Stake in Profitability of Family Farms

PREPARED REMARKS OF

RICHARD DAILEY
4425 Goodson Road
West Jefferson, OH 43162
614-879-6457

before the

HOUSE AGRICULTURE SUBCOMMITTEE ON
CONSERVATION, CREDIT AND RURAL DEVELOPMENT
October 31, 1985

Mr. Chairman, members of the Subcommittee and distinguished guests. My name is Richard Dailey and I am a farmer from Central Ohio. Last year, I farmed 1000 acres growing corn and soybeans as well as contracting some tomatos to a commercial cannery. I have been a PCA and Land Bank borrower and stockholder for the past fifteen years. Earlier this year, I was able to reach a settlement with them and turned over essentially all my assets in exchange for debt settlement. During my years as a Farm Credit System borrower, I think that I can honestly say that I was more active in the Cooperative system than the average borrower. During the past five years, I have devoted untold thousands of hours to study of and dealing with the Farm Credit System on my own behalf as well as helping other farmers with their problems with the System.

The problems of agriculture in general and the Farm Credit System in particular are very real as well as being very complex. Unfortunately, with the discussions of tremendous losses being sustained by both the farmers and the Farm Credit System, we all tend to lose sight of the forest while looking at so many trees. We are dealing with many suppositions as to future courses of action and ignoring some of the basic factors as to how we got where we are and what can be done about it based on past performance. I would like to confine my remarks to what I consider the three basic facts of the situation in order to reach a logical conclusion.

FIRST: The Farm Credit System is the biggest single contributing factor to the present problems of agriculture today because of its liberal and irresponsible lending practices of the Seventies.

SECOND: During the Seventies and up until June of this year, the Farm Credit System made tremendous profits from the American farmer and has steadfastly refused to return those profits to the farmer.

THIRD: During the economic troubles of the Eighties, the Farm Credit System has demonstrated a total lack of ability to deal with these problems and to assist the farmer in an equitable manner.

This subcommittee has enough knowledge of the practices of the Seventies. The Government, the universities and suppliers were all telling the farmer to expand his operations on borrowed capital. The farmer was seduced into forgoing an operational profit from his work and relied on the never-ending inflation to build an estate for his children. We all had to have a bigger tractor, a bigger combine, a bigger farm in order to be "efficient."

We must all share the blame for this irresponsible course of action. However, who financed these land purchases at continually increasing prices? Who refused the farmer the money to repair his old combine but loaned him the money for the new one because this was more efficient use of capital? Who loaned the farmer money to bid higher cash rent so he could justify the larger equipment?

Inflation was the name of the game in the Seventies. Inflation is controlled by the amount of money available. The biggest source of money was the Farm Credit System. Therefore the Farm Credit System was the biggest single contributor to the programs of the Seventies which led inexorably to the problems of the Eighties.

I accept that I was a willing participant in the total excesses of the Seventies. However, I resent that the Farm Credit System rejects any and all responsibilty for those excesses.

The profits of the Farm Credit System have got to be the best kept secret of all time. As stockholders, we were led to believe that we were borrowing money at the lowest possible rate and therefore should not expect a patronage refund from our benevolent cooperative. However nothing could be further from the truth. Tremendous profits were made by the System, primarily in the Land Bank at the District level where they were subject to the least scrutiny.

The GAO report of October 4th is the first public recognition that the System has over 6 billion dollars of earned surplus available to assist the farmer. At the same time, the farmer-owned stock in the FCS is only about 5.5 billion. The individual farmer's investment in stock in the FCS represents a significant investment to that farmer. Yet the System has an even greater retained surplus which represent past earnings made from that farmer. These are real values which the farmer has a right to yet have been denied him.

Maybe during the Seventies, the profits of the FCS could have been justified if they had been returned to the farmer in the form of equity. However, Land Bank's combined surplus and loss reserves increased 42% from December 1981 to December 1984. I characterize those profits and their retention by a cooperative during a period of unprecedented economic hardship on american farmers as unconscionable.

During the same period from 1981 to 1984, the Farm Credit Banks increased their operating expenses by 72%. The biggest factor in that was salaries. When the farmers were losing money, their employees at Farm Credit were certainly not experiencing any hardship. In light of this increase in operating expenses the statement on page two of the GAO report that, "FCA officials believe that those savings (management cost savings) would be limited" is entirely believable.

Also during that period, the Farm Credit Banks' investment in buildings and equipment increased by 127%! How many farmers were able to more than double their investment in equipment and land from 1981 to 1984? While the FCS was requiring farmers to liquidate assets and reduce operations, it was doing the exact opposite.

Do I really have to tell the members of this committee that the Farm Credit System has been inadequate in dealing with the present crisis in agriculture? I am positive that each and every one of you has heard many complaints from your own constitutents.

We have been denied any semblance of rights as stockholders in our own cooperative. The district bank management has dictated policy and management to the local associations. We have seen a continued concentration of power in the hands of unaccountable bureaucrats at the district level. Local officers and directors have no authority to do anything. I have seen my PCA go from 3200 members and 160 million in loans to something like 1000 members and 25 million in loans. Now they are going to eliminate the local association entirely. Sure they are going to do this subject to a member vote, but they openly threaten retaliation in the form of higher interest rates and reduced funding for associations who don't go along with their consolidation plans.

During the Seventies we were used to going in to pick up money on the basis of a phone call and a simple application. Today, you cannot get an answer from them, yes or no, in less than months. Furthermore you cannot identify the man who made the decision. Everything is done by a "committee" and you can't even find out the members of that committee.

The Farm Credit System is incapable of handling the present crisis in agriculture because it has no clear cut lines of authority to establish accountability to either the Government at the top or the farmers at the bottom. Farmers are completely disenfranchised by the simple power of the District officials to remove a local director. I am sure that you Congressmen are frustrated by your lack of control over the System.

Money is not the most important thing in any banking institution. Rather it is the feeling of trust, confidence and reliability that the bank instills in its customers. We saw evidence of that with our savings and loans in Ohio last spring. The recent actions of the Farm Credit System have destroyed the trust, confidence and reliability that the farmers had for the systyem with the result that those farmers who can get out of the system are leaving in wholesale numbers. Not only are the good farmers leaving, but the good employees are leaving. I used to know every employee of my PCA on a first name basis. Today they are all strangers. As an employee who quit said, "The FCS is going to be left with nothing but bad loans and bad employees." If you have good people, you can handle some bad loans. Without good employees, you can't handle anything.

The subject of these hearings is supposedly a bail-out of the Farm Credit System. I feel that the taxpayers have no responsibility to bail-out an economic enterprize in a capitalistic society. They do have however a social responsibility to provide a means for the individual farmer to maintain a minimum standard of living. If we are here talking about maintaining exorbitant salaries and power structures for a bunch of FCS employees, then I say forget it. If we are interested in helping farmers maintain a minimum standard of living while feeding the nation, then I say let's help them out.

I don't think that a bail-out of the Farm Credit System as it presently exists would really help the farmer. For the past 15 years, the actions of the System have not been in the best interests of the farmer. It's recent actions have been more concerned with protection of their own system than with really assisting the farmer. They have not demonstrated any track record to justify their continued existence.

Any assistance rendered must be aimed at the farmer. Further it must be directed to those farmers who are most needy and worthy of assistance. We do not ask for an unjustified hand-out, merely a means of maintaining our dignity and a minimum standard of living. The fact must be faced that farmers are incapable of paying a significant portion of their debt. Some means must be devised for dealing with that fact.

We are opposed to the Agricultural Conservation Corporation proposal as we understand it since it is for the benefit of the banking industry as opposed to the farmer. Many people feel that the proposal will hasten the foreclosures instead of slow them down. A major concern is the form of operation of this land while ACC owns it and the ultimate disposition. In order to maintain our way of life, family farmers must stay on the land and the land must ultimately revert to small entreprenuerial enterprizes such as the family farmer.

We are opposed to any unilateral bail-out of the Farm Credit System which would not help the farmers who have significant debt problems with commercial banks. Any assistance program must have equal benefits to all farmers not just those who are in the Farm Credit System.

There are three major immediate problems facing the Farm Credit System. First, the increased cost of funds on the bond market. Second, farmer fears of loss of stock investment. And third, the actual extent of losses to be sustained in the loan portfolio.

The bond market has recently placed a 1% premium on Farm Credit System securities to cover the imagined risk of FCS failure. This cost will be passed on directly to the farmer-borrowers. This situation cannot be allowed to continue.

The farmers of this country are faced with losing 5.5 billion in stock invested in the Farm Credit System. These farmers cannot afford to lose that much money on top of all their other problems. Further, it is severely hurting the Farm Credit System's ability to attract good new customers. This situation cannot be allowed to continue.

Nobody knows the real extent of the losses facing the farm economy. Most estimates speak of 5 to 10 billion in capital needed to alleviate the problem. Is this going to come from the farmer, the bond market or the American taxpayer? If the farmer could pay it off, he already would have done so. If the bond market has to pay it off, this cost will just be spread to investors, stockholders, pensioners and customers of financial institutions. Also, a lot of the bonds are held by state and local governments. The question is not one of who is going to pay it. We are all going to pay it. Rather the question is the form of the payment. That leaves the American taxpayer to pay it as the broadest base and least disruptive to the total economy.

The farmer does have one very significant asset that he has been unable to touch yet. That is the past profits of the Farm Credit System. These profits are in excess of 6 billion dollars, they came from the farmer, and they belong to the farmer. If the American taxpayer is to pick up the tab for the farmer, then that taxpayer has every right to expect this 6 billion dollars to be used up before the US treasury spends a dime and the taxpayer should expect to be in control of the remaining situation. This is the price tag for Government intervention.

This country is already strangling on a bureaucratic maze. We have a Farmers Home Administration, a Farm Credit System and a Bankruptcy court system. We don't need another quasi-governmental agency to compound the problem. Instead of creating another agency, just take over the existing Farm Credit System. You are automatically picking up a 6 billion dollar cushion before you have to realize losses. Let the new Federal Farm Credit System hold the land. If the previous farmer doesn't want to farm it, let the land set idle in a strategic reserve. If a farmer is having trouble with a commercial bank, let the farmer have the option of transferring that loan to the new Federal Farm Credit System where he will have the right to remain on the farm and produce a livelihood for himself and his family.

We don't need an ACC. We need an immediate guarantee by the Federal Government of both the outstanding bonds of the Farm Credit System and the farmer-owned capital stock of the FCS. We need an immediate end to the exorbitant operating expenses of the FCS and a stop to the $150,000 salaries in FCS. We need a reduction in the interest costs to the surviving and needy borrowers. We need a system whereby distressed farmers have certain rights and can retain some dignity and a means of feeding their families. Above all, we need a dependable and responsible source of credit for agriculture which will use its resources to improve a bad situation instead of worsen it. We feel that this could best be accomplished by a Federal takeover of the Farm Credit System.

Mr. Chairman and members of the Subcommittee, I thank you for your consideration in allowing me to present my views.

STATEMENT TO THE SUBCOMMITTEE ON CONSERVATION, CREDIT AND RURAL DEVELOPMENT OF THE COMMITTEE ON AGRICULTURE, U. S. HOUSE OF REPRESENTATIVES, OCTOBER 31, 1985

Tom Saunders
Prairie Farm, Wisconsin

My wife and I and our 4 children are dairy farmers in Northwest Wisconsin. I am a Board member of the Wisconsin Farm Alliance and the North American Farm Alliance. I want to thank the Chairman and the Members of the Committee for the opportunity to share with you the concerns we in the Farm Alliance have for the future of family farming in the USA.

There can be no bail out for the Farm Credit System (FCS) without a price for farmers. The plan put forward by the FCS here yesterday may bail out the system, but will not bail out the farmers. There is very little difference between their early proposal for an ACC, which was widely rejected as only a system bail out. Without higher prices to increase farm income, the "bad loan" bought up by the loan warehouse would stay "bad" and would end up in an ACC type holding corporation. Warehousing is a plan for foreclosure. It is a plan to expedite the transfer of land from farmers to investors.

As an organization that does advocacy work for farmers, we are used to the System negotiating in bad faith. I must clarify this by saying that When I refer to the FCS, I mean the "100 men" the gentlemen from Grassroots in Texas spoke of in their testimony yesterday and not the local managers and Borrower Board members.

With the exception of certain well managed branch offices, the System as a whole encouraged over-borrowing throughout the '70s. Now, in the '80s, when the economic situation has gone bad, they have turned away from their share of the responsibility for the crisis, and propose to save their good loans or their bonds, at the expense of the farmers.

This behavior is consistant with the vision for agriculture laid out in the FCS's Project 1995 Report, a study prepared by some of the 100 men. In this vision, there is plenty of talk about assets, capital, centralization and resources, and nothing about protecting farm families and rural communities, and ensuring democracy. I quote from the FCS's Project 1995 final report:

"The System can no longer afford the luxury of a slow, methodical decision making process that involves grass roots input to the extent utilized in the past." (p. 19)... (we should)"Redefine the system's cooperative business philosophy and principles to keep pace with the value systems of its owners and customers." (p. 6)

This is clearly not what the FCS was created for. The FCS was created to provide credit for farm families that are members and potential members, not as a centralized bank which moves to cut loose its distressed members to protect itself and its bonds.

The only way to change this vision is to encourage the participation of people in its development. Democracy cannot be sacrificed for speed. The system must see its role as serving the whole rural community, not just its current "owners and customers." That is the only way to protect the welfare of "all the borrowers."

Here is our position on any bail out of the FCS:

1. Implement a temporary moratorium on all foreclosures until farm prices are raised to levels that can sustain the farm debt.
2. Target bail out funds to provide interest rate reductions to all members, and eliminate the present policy of charging higher interest rates to distressed borrowers.
3. Require an annual independent, outside audit of the FCS.
4. Establish a Borrowers Bill of Rights that...
    - sets a clear policy of forebearance, and establishes a minimum family living allowance
    - allows members access to by-laws, files and membership lists.
    - sets a clear and impartial appeal process.
5. Halt all mergers of local associations and moves to further centralize the FCS.
6. Expand and fully implement the Young, Beginning and Small Farmer (YBS) program established by Congress in the 1971 Farm Credit Act, and include former borrowers.

I would like to go back to my original point, "there can be no bail out of the system without a price for farmers. As the independent bankers testified here yesterday, you cannot solve the crisis in the FCS without an increase in farm income.

It is very frustrating to those of us in the farm movement who have struggled without adequate resources to make the members of the Agriculture Committee and the whole House see the crisis in agriculture in *human* terms, to look at the loss of farm families and the destruction of rural communities that is taking place. We spent all summer argu ing about what farm programs would do to exports and almost no time discussing their effect on people and rural communities.

Now, when the crisis is coming into full view, we are told that farm prices cannot be part of the discussion.

The way my neighbor Alfred Lokenson describes it, "They told us to dig a ditch but they locked all the shovels in the tool shed. Now we're all out here struggling to get it done with old buckets, sticks and our bare hands, fighting with eachother about the best way to do it and getting nowhere." Somebody has got to go to the tool shed and bring out the shovels, because the people are ready to take hold of the handle.

This Committee, the Subcommitte on Conservation, Credit and Rural Development, as well as *any* committee in the Congress, must deal with these issues from the perspective of the whole country, and not just from the perspective of the 100 men and their bonds. Thank you.

Testimony of Eugene Severens
Center for Rural Affairs; Walthill, Nebraska

before the
U. S. House Committee on Agriculture
Subcommittee on Credit, Conservation and Rural Development

October 31, 1985
Washington, DC

Mr. Chairman, thank you for this opportunity to provide testimony on the farm credit crisis and, in particular, on the problems associated with the Farm Credit System. The Center for Rural Affairs is an unaffiliated, non-membership organization founded in 1973 and located in Walthill, Nebraska. The Center is governed by a 24-member board of directors, consisting of half Nebraska farmers and ranchers and half rural Nebraska business people, attorneys, clergy and educators. Center staff has analyzed and monitored federal credit policies for farmers for several years, conducted a credit counselling service for nearby farmers and has prepared brochures and handbooks designed to help farmers with their credit problems.

The "De-capitalization"of U. S. Agriculture

American agriculture was over-capitalized in the 1970's. A host of tax shelters which over-stimulated capital investment in agriculture; inflation; soft credit collateralized on the false hope of infinitely appreciating land values; and speculation in farmland development schemes combined to pour amounts of capital into agriculture that could not be justified on the sector's ability to produce income. We are now experiencing the tragic personal and family costs and the inevitable financial and institutional adjustment to that over-capitalization. In Nebraska we are in the midst of unprecedented farm liquididations and "de-capitalization" in which borrowers, lenders and equity-holders alike are experiencing substantial capital losses.

Only government action can place controls on this liquidation and make sure that losses are equitably shared.

The Need For Government Involvement

We think a number of economic conditions justify both federal and state intervention. Some of these conditions include:

(1) Most liquidation of assets is arbitrary and inefficient prompted by antiquated state liquidation and foreclosure laws and condoned by both the federal FmHA and the Farm Credit System. If debt collection and liquidation procedures were modernized, we think it is possible to help many farm operations scale down successfully and, at the same time, protect lenders' interests.

(2) Land values are falling below rational levels which only serve, in a vicious circle, to prompt panic and more disorderly liquidation. If this "over-shooting" of rational values results in excessively low land prices it may trigger another roller coaster ride of speculation.

(3) On the other hand, these low land prices represent a once-in-a-lifetime investment opportunity. Failure of the government to help realize this opportunity for efficient family operations which are start-

·ing up or starting over would result in an unwarranted concentration in land ownership.

Three Strategies: Survival, Restructuring, Rebuilding

In formulating government action we should take note of three general financial situations which farmers and lenders are or will be facing. Government strategies need to be separately fashioned for each of these situations. Those three strategies are: (1) basic survival and debt discharge strategies for farmers facing imminent liqudation or with very low networth; (2) restructuring strategies for farmers who need to protect an eroding but still moderate networth; and (3) stabilizing and rebuilding strategies designed to stabilize land values and provide farmland purchase opportunities for rebuilding efficient family operations.

It should be noted that public programs can be most easily designed for the first and third approaches. The second approach--restructuring of debts or assets--will make sense for many farmers and ranchers only if income improves. It is also worth noting that the first approach--basic survival and debt discharge involve little public expense. Such strategies would work by improving access to bankruptcy or by redesigning liquidation laws to facilitate farmer-lender agreement on scaling down to manageable debt levels. Liquidation procedures right now are designed as a terminal event--the death of a farm.

Criteria for Debt Relief Plans

Farm debt relief plans at any level of government must be consistent with properly considered public purposes and be carefully designed to assure that those purposes are fully served. We submit the following criteria for evaluating the many plans being submitted:

(1) Loss sharing: Farmers and ranchers, lenders, and government all share some of the responsibility for or have assumed some of the risks of the current debt crisis. Any government plan to absorb or postpone the coming round of capital losses should balance each party's ability to absorb additional loss, its responsibility for the current situation, its assumption of risk for the on-going losses, and its affinity to the articulated public purpose being served by the relief plan.

(2) Family farm and ranch focus: The long-standing purpose of government farm lending programs has always been to maintain and create opportunities for efficient family-size farm or ranch operations. There is no reason that that public purpose should be suspended now. If there's going to be a public investment to absorb some of the loss, then that investment should be designed to work through family farms and ranches and not be direct transfers of cash which are controlled largely by lenders.

(3) Controlled liquidation: Public debt relief programs should not encourage uncontrolled or unnecessary liquidation but should promote selective scaling down of assets. Unplanned, unilateral liquidation is a drastic action which affects personal livelihoods and family and community well-being. It is also inefficient because it arbitrarily breaks up an integrated set of farming assets and typically returns to the secured lender less than the use value of the asset.

(4) Accessibility: Information about and access to any plan should be readily available to all parties. Access to programs and procedures which is unilaterally controlled by lenders is not only unfair, it also promotes arbitrary and inefficient results. We note that agriculture has a long and successful tradition of using local farmer committees to determine access to programs. We think this device should be considered for any federal farm relief measure.

(5) Cost-effectiveness: Any public funds allocated to the debt crisis will be limited and should be used so taht as many people as possible will be benefitted in a meaningful way. Typically this might mean, depending on the program, that modest ceilings should be placed on benefits so taht the available finite resources are not absorbed disproportionately.

(6) Avoidance of past abuses: In designing any rescue plan, past abuses and shortcomings will be identified. Every effort should be made to prevent and correct these problems.

The FCS: Out Of Control

The desperate financial conditions in agriculture should be serving as an opportunity to reassess the total role of government in agriculture and develop a comprehensive program that included tax and income policies along with credit programs. If the current discussion focusses only on credit and the FCS in particular, then at the very minimum, it should take this opportunity to thoroughly evaluate the last twenty years of FCS performance and reassess the public purpose served by such a system.

We think that the Farm Credit System is out of control in more ways than just financial. It is out of congressional control, and the system's managers have lost sight of the cooperative principles under which the system was created, and it has lost sight of the everyday farmer and rancher it was created to serve.

The irrational drive for consolidation and centralization of control is perhaps the most disturbing trend. "Project 1995" and high-level FCA administrative action indicate that current management has stood cooperative principles on their head. The system was designed to solve the unique credit needs of everyday farmers and ranchers by linking them with money markets on the east coast. Current management seems bent on reversing this link by rejecting these everyday farmers in favor of more easily financed "blue chip" producers. Mr. Chairman, the system was created to serve farmers, not vice versa.

As the Committee knows, many FCS districts face merger votes in November. Mr. Chairman, we think this merger is an attempt to preempt Congress by limiting congressional options by a presumed "yes" vote for merger. This merger not only has little merit, it is poorly timed. The merger vote is different in each district and is a piecemeal approach at best. We urge Congress to develop a comprehensive rescue and reform plan and disregard the piecemeal results of merger.

On the merits of merger, we find little reason to support it. In addition to effectively ending any chance of meaningful local control, we think it increases the overall vulnerability of the system. For example, a few years ago the Omaha district FICB (IA, NE, SD, WY)--the troublespot of the system--approved enormous loans in the Valentine (NE) PCA for irrigation development in north central Nebraska. That PCA was liquidated last year, and we have learned that, of the PCA's $12 million worth of nonperforming loans, over $8 million--all approved by Omaha--were held by a single, now bankrupt, irrigation developer. That one borrower broughtdown the Valentine PCA and many of its other borrowers as well. Local merchants and local government were also victimized by this one loan decision. If the proposed four-state merger had been in place earlier, perhaps the entire four-state area would be in more trouble than it is now.

The FCS wants desperately to be beyond Congress' control. The system in its modern era has a history of defying Congress. For example, in the 1980 FCS amendments, Congress created the special "young, beginning, and small farmer and rancher" program. The system responded all right--by authorizing higher interest rates for these farmers. I suggest that that result is a perversion of Congress' intent and stands as a warning that any FCS reforms adopted must be carefully legislated to prevent this type of cynical manipulation.

Mr. Chairman, as you well know, this is an extremely complicated issue. Our organization is working with others to develop a a package of FCS reforms. We look forward to sharing them with you in the very near future. Thank you for this opportunity to provide testimony. These hearing should prove invaluable in providing needed information and exchange of ideas on a very critical topic.

IOWA
NATURAL HERITAGE
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"FOR THOSE WHO FOLLOW"

TESTIMONY
FROM DUANE SAND
RESOURCEFUL FARMING PROJECT DIRECTOR

TO THE HOUSE SUBCOMMITTEE
ON CONSERVATION, CREDIT AND RURAL DEVELOPMENT

OCTOBER 31, 1985

While the farm credit crisis is the major issue of this hearing, I am sure that most in this room are also extremely concerned about the growing national debt. My remarks will concentrate on a conservation and credit proposal that makes sense at this time of deficit spending.

Historically, deficit spending has been a powerful tool to moderate economic recessions. In the case of agricultural credit, there is reason to believe deficit spending is now needed. The Wharton Econometric Model forecasts a loss in income to the federal government between 14 and 22 billion dollars by 1993 if the federal government fails to respond to the farm credit crisis.

Timely intervention would also save several billion dollars that may be required to capitalize the Farm Credit System and the Federal Deposit Insurance Corporation, and to cover Farmers Home Administration loan losses.

Congress has the choice to pay now or pay later, but Congress must make an investment now if it wishes to slow the future growth of the federal deficit.

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DES MOINES, IOWA 50309 / 515/288-1846

This investment must meet four criteria to be fair and effective:

1) it must channel funds to financially insolvent producers so they can pay lenders who also cannot meet obligations;
2) it must prevent excessive devaluation of agricultural assets so that even more producers and lenders do not become insolvent;
3) it must be reasonably fair to other competitors in the marketplace; and
4) it must assure that current taxpayers or future generations who will eventually pay for the program are getting the most for their money.

The Iowa Natural Heritage Foundation has researched such a proposal involving the federal purchase of conservation easements on agricultural land subject to foreclosure. The conservation easements concept was placed in the 1985 Farm Bill by this committee to restructure FmHA loans. Additional easement purchases authorized in H.R. 3557 would slow the loss of asset values in severely depressed land markets by keeping farms off the market and by encouraging private purchases of land. In addition to these benefits, the public receives long-term conservation of soil, water and wildlife resources.

A conservation easement is a legal agreement in which the landowner relinquishes the right to certain specified uses of the land. Easements can permanently protect conservation interests while leaving the land in appropriate agricultural production under private ownership and management. The federal government has purchased conservation easements for over 50 years, and further encourages their use by allowing tax deductions for donation of easements to conservation agencies or organizations.

The purchase of conservation easements is fair because it is not a "give-away" program. The government is purchasing interest in real property which can be sold back to a landowner if there are higher priority conservation needs. During the period it owns the easement the government will receive the conservation benefits it negotiated. In many cases it will also experience some savings in farm price support programs because of reduced production required by the easement.

While partial sale of assets will allow many producers and lenders to stay in business, the survivors will be determined by the marketplace rather than the government. The sale of easements will not save all farmers or lending institutions, but will stabilize the land market so more will have collateral or asset values needed to remain in business. Our opinion polls indicate about half of the land subject to foreclosure could be kept off the market through a conservation easements program.

Purchase of easements offers a politically acceptable alternative for assisting financially troubled individuals and lenders without being unfair to their competitors. Such targeting of funds is essential since price support programs spread assistance too widely to prevent a financial crisis.

Our research shows the Secretary of Agriculture currently has authority to purchase conservation easements. Under a barter system using surplus commodities for a "payment-in-kind", the program could be implemented immediately without appropriations. The program could be administered through the personnel and procedures of the Agricultural Conservation Program, which is a cooperative effort of the ASCS and the

Soil Conservation Service. This existing authority, process and personnel may be essential for the timely salvaging of the Farm Credit System should its bond market fail.

With all these points in mind, it appears that a conservation easements program would be fair and effective. But most important, it is a bargain for present and future taxpayers who pay for deficit spending. Americans will be paying for the farm credit crisis long after it passes. Unlike other proposals, the purchase of easements conserves our soil, water, wildlife and natural areas for the benefit of those who follow.

Thank you for the opportunity to testify today. I request to submit additional information for the record.

(Attachment follows:)

New safety net proposed in behalf of conservation and quality of life

The following proposal for addressing the agricultural plight of many farmers is by Duane Sand, resourceful farming project director of the Iowa Natural Heritage Foundation.

Government leaders are in a quandary. Despite federal farm programs which pump billions of dollars into the agricultural economy each year, more than 200,000 producers are falling through the safety net and facing foreclosure. These producers are pulling the lenders and suppliers down with them.

The current system of relying on target prices and price support loans to bolster the agricultural economy simply is not protecting rural economies. It gives too much federal assistance to those producers who have less need for it, and not enough assistance to those who are desperate for help. For example, 12% of U.S. farmers reaped nearly half the $6.6 billion spent in government subsidy programs last year. Robert Thompson, the Agriculture Department's chief economist, has stated, "The way we're running our programs right now, we're skewing our payments heavily toward the largest producers." These farms which earned 45% of federal subsidies in 1984 have an average net worth in excess of $1 million.

Assisting troubled producers through increased funding of current programs is not reasonable, in light of the federal deficit. Therefore, government must consider moving financially sound producers into a more free market system. Rural economies in several states could collapse unless scarce government funds are better targeted to those producers who cannot meet their debt obligations.

A FARM program targeted toward needy producers causes a significant problem for government leaders; however, it is politically unpopular. Targeted programs may be considered unfair because some producers receive greater benefits than those perceived to be more efficient producers. Offering farm subsidies to every producer is an easy way to gain farm votes, whereas direct assistance to financially troubled producers could be politically risky. Leaders will be much more likely to support a fair program in which government assistance is earned instead of given freely.

A program allowing government purchase of conservation easements from financially troubled producers is a politically acceptable option. Under this program the landowner would voluntarily sell certain property rights which do not significantly contribute to net annual income. Rights which could be acquired for the public's benefit may include:

- the right to use or sell prime farm land for residential, commercial or industrial construction;
- the right to produce grain on highly erosive land;
- the right to irrigate land for crop production when water is needed for public uses;
- the right to produce grain in natural waterways, flood plains or wetlands;
- the right to produce grain on headlands or endrows where filter strips would improve water quality and wildlife habitat;
- the right to personally limit public access for hunting, fishing or hiking;
- the right to manage undisturbed natural lands designated as wildlife or nature preserves.

THE GOVERNMENT payment for easements on all or part of the land would often be sufficient to restructure the producer's debt. The land would remain in private ownership and management, with appropriate agricultural production. Purchase of easements provides an additional safety net, but the payment is not a "give-away." It is a purchase of assets previously owned by the producer. The government receives interest in real property as well as conservation benefits in return for its money.

It would be difficult for financially sound producers to claim that the program causes "unfair competition" since easement restrictions will often reduce production by competitors. Also, landowners already have the option to donate conservation easements to local government or private organizations, and to receive substantial tax benefits for such a donation. While purchase of easements would be directed to those in financial need, the tax benefits of conservation easements are available to all.

As a debt restructuring program, the program would involve voluntary negotiations between the producer, the lender who also owns interest in the property, and a conservationist with the Soil Conservation Service. They would determine which natural resources should be protected by easements. A professional appraiser would determine the government payment for each easement based on the associated loss of land value. The USDA's Agricultural Stabilization and Conservation Service would purchase the negotiated easement, either with cash payment or barter with government-owned commodities. ASCS would also monitor compliance to assure easement agreements are honored in the future.

IN ECONOMICALLY depressed areas, the easements program could encourage orderly sales by allowing the direct purchase of easements on repossessed property. This option creates an incentive to bring buyers into the land market. Buyers may choose to purchase land now, before it hits bottom dollar, to ensure that the land is free from restrictions when it is purchased.

Conservation easements are binding on all present and future owners of the land. However, the ASCS would have the option of selling the easement back to the landowner at some time in the future. Proceeds would then be used to purchase easements of a higher priority, perhaps from another financially troubled producer. This creates the potential for a type of "revolving fund" to keep future program costs to a minimum.

With all of these benefits in mind, it appears that a conservation easements program would be a wise addition to federal farm policy. It would provide immediate assistance to many producers with the greatest need, without compromising market-oriented policies. It would promote a more stable environment for agricultural lenders, suppliers and producers by providing an alternative to foreclosures, bankruptcies and an unstable land market. This additional safety net for agriculture would benefit all taxpayers who depend upon conservation of natural resources for future prosperity and a high quality of life.

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GULF & GREAT PLAINS LEGAL FOUNDATION

JERALD L HILL
President

October 25, 1985

TESTIMONY OF

DR. J. BRUCE BULLOCK

MR. TED ABELE

MR. JOHN GILL

MR. MARK J. BREDEMEIER

PRESENTED TO

U.S. HOUSE OF REPRESENTATIVES' AGRICULTURE SUBCOMMITTEE

ON CONSERVATION CREDIT AND RURAL DEVELOPMENT

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FARM CREDIT SYSTEM TESTIMONY OF MARK J. BREDEMEIER[1]

Mr. Chairman, members of the Committee, my name is Mark J. Bredemeier and I am General Counsel for the Gulf & Great Plains Legal Foundation, a public interest law foundation based in Kansas City, Missouri and serving eight states in the Midwest, including the North and South Dakotas, Nebraska, Kansas, and Missouri. We thank you for this opportunity to present our analysis of the crisis facing the Farm Credit System.

In addition to the Foundation's summary analysis, Gulf & Great Plains submits the written testimonies of three individuals familiar with the financial crisis affecting today's agricultural economy: John Gill, operator of an 800-acre farm in Platte County, Missouri; Ted Abele, an agricultural consultant for a 17-state territory in the Midwest and a former administrator within the Farm Credit System; and Dr. J. Bruce Bullock, professor and chairman of the Department of Agricultural Economics at the University of Missouri -Columbia, also formerly a research manager within the Farm Credit System, and a noted author of numerous studies and reports regarding the Farm Credit System and the farm credit crisis in the United States. Included as exhibits to Dr. Bullock's testimony are two reports prepared by Dr. Bullock and the Food and Agricultural Policy Research Institute. At this time, I offer into the record these testimonies and exhibits.

The single most important task facing this Committee in its examination of the Farm Credit System's liquidity crisis is to identify and deal directly with the specific cause of the problem: excess debt. This may be defined simply as farm debt that cannot be repaid either from farm income generated by the assets purchased with borrowed capital or from off-farm income of the borrower. Much of the testimony this Committee will hear, like much of the media attention devoted to today's declining agricultural economy, will focus on the symptoms of the problem: the precarious welfare of our farmers and their families, the looming insolvency of more and more agricultural lenders, and the uncertain future of rural America. While these are smgnificant concerns to be sure, they should be -- must be -- dealt with as crises separate from that facing the Farm Credit System.

These concerns must be distinguished from the cause of the liquidity crisis, which is the presence of an enormous volume of debt that cannot possibly be repaid by farmers this year, or next year, or, for many, many farmers, ever -- even with farm product price increases, higher price supports, zero interest rates, loan guarantees, expanded export markets and more credit through expanded government loan programs. Our national leaders' failure to distinguish the symptoms from the cause will only encourage them to take the primrose path of throwing good money after bad in hopes of helping everybody. Taking such a path promises little chance of significantly aiding farmers and lenders in the short-run, but a high probability of ensuring, ultimately, even greater economic disaster for farmers, lenders and the American taxpayers.

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[1] Nothing herein is to be construed as necessarily reflecting the views of Gulf & Great Plains Legal Foundation or as an attempt to influence legislation before Congress.

In a prophetic report prepared by the Food and Agricultural Policy Research Institute this past March, Dr. J. Bruce Bullock, chairman of the agricultural economics department at the University of Missouri, not only identified the cause and severity of the impending farm credit crisis, but he discarded the many panaceas now proposed by wishful thinkers as easy ways out of the debt crunch and offered two painful, but necessary, courses of action: debt removal or do nothing. This report in its entirety is set out in the materials attached to Dr. Bullock's written testimony. In Dr. Bullock's words, one solution to the excess debt problem would require that "the debt and associated principal and interest payments be removed from the agricultural balance sheet and cash flow." Public policy would then determine how this wealth loss would be distributed among borrowers, lenders, and the government. More precisely, the question narrows to how much of the farmers' and the system's investors' losses will the federal government underwrite. Parenthetically we might at this point ask what about commercial lenders? Will the federal coffers be opened under this option to cover their losses as well? At what further cost?

The better alternative proposed by Dr. Bullock is to simply "let the chips fall where they may," with wealth losses being shared between borrowers and lenders. Again, the lenders primarily at risk are the system's solvent stockholders and institutional bondholders. A do nothing policy is workable and should be promoted as a free market approach, despite substantial increases in farm foreclosures and bank failures. But it will be up to our policymakers to decide if certain inevitable structural changes to the agricultural industry and rural communities across the country are an acceptable price to pay now for a long-term solution to the farm finance problem.

Enter now those who cry out the need for a federal bailout of the system. Presumably, this would involve an infusion of capital into the system to continue or expand present loan programs. Of course, the rationale for a bailout seems plausible -- even admirable. The price to pay for a move toward a more free market agricultural economy -- foreclosures, bankruptcies, bank failures and rural regeneration -- is just too high, some would argue. But query whether such a price must eventually be paid. We have too many farmers and too much acreage in production, both due to technology and our ever-increasing productive efficiency. That's not going to change. Five percent of our farmers went under last year and ten percent are expected to do the same this year. Many "small" farmers producing less than $100,000 a year in gross sales already rely on off-farm income, rather than farm income, to get by, often at income levels higher than the national average. Rural communities are already suffering the effects of a changing agricultural industry as larger farmers no longer trade on Main Street but purchase their supplies from wholesalers and businesses in the cities. All this is true now, today, without a bailout.

Will more money, more credit, resurrect the plight of the economically nonviable small farmer and thwart the dynamics of our changing farm economy? We think not. If we want to help the small farmer, craft a direct relief program to wean him from farming; it will be cheaper for the U.S. taxpayer in the long-run. If we are worried about the economic future of our rural communities, let us encourage other forms of rural development (such as manufacturing) that will relieve rural America from its ominous dependency on agriculture.

John Gill is a small grain farmer and seed processor in Platte County, Missouri. John is also a participant in the Agricultural Leadership of Tomorrow program for young people involved in agriculture. In his testimony, John states: "The trend in the American agricultural market since the 1930's has been toward fewer and larger farms. Many government programs and much farm legislation have been enacted to stop this trend, so far with no success. It is my contention that we cannot afford to write legislation to effectively reverse this trend because of budget constraints. I might also add that we cannot in any event write legislation to thwart what market forces and technology are gradually bringing about in agriculture. A massive FCS bailout could only slow this trend for non-economically viable farming units and would only delay the inevitable bankruptcy of these farms. We are doing a disservice to these farmers and their families by stringing them along and putting them under continued stress."

Simply put, a "shakeout" in our agricultural economy is underway and more credit will simply exacerbate the lending crisis. As Dr. Bullock cautions in his report: "Providing additional debt to these farmers is analogous to putting more water in the swimming pool in an attempt to save a person observed to be drowning in water over [his] head."

Without doubt, much needed reform is on the way for our Farm Credit System. The centralization of the system's regionalized lending institutions and programs is mandatory and may well be accomplished in an autonomous Farm Credit Corporation of America. Improvements and accountability in lending, management and accounting practices are likewise indispensable. Careful scrutiny must be given the claimed need for federally-sponsored intermediate credit banks, production credit associations and banks for cooperatives. But beyond system reform lie darker questions: Where are we going with our national agricultural economic policies? Can the industry effectively survive in a economy replete with federal intervention, subsidization and bailouts?

Ted Abele, an agricultural consultant acutely aware of financially-stressed farmers in seventeen states in the Midwest, has an answer to this last question. In his written testimony, Mr. Abele contends: "[I]t is unreasonable to assume that the federal government can or should even consider trying to salvage all of the financially-troubled farmers, agribusinessmen or commercial banks which currently have no reasonable likelihood of recovery. To pump billions of dollars into "saving the family farm" on an indiscriminate basis is to repeat the same blindfold approach that has proven disastrous with government credit institutions like FmHA. Any effort to bail out all the troubled farmers in the nation would not only be too financially burdensome, it would also be idealogically unacceptable. It would virtually prohibit failure in agriculture regardless of the deficiencies of management. The federal government does not have the financial resources, nor the obligation, to assure every farm creditor or farm producer success. An across the table bailout of financially-troubled farmers will issue a highly undesireable signal to every producer in every business, that being a federal free ride. That approach would also penalize the farm producers who are better managers and who have worked themselves into a more favorable financial position.

"There exists in agriculture today a great mass of farmers who, although severely burdened by the difficult times in agriculture, do not endorse the mass infusion of government capital into agriculture or a broad bailout of every neighbor in financial trouble. The government, like a drug pusher in a school yard has never been a close and trusted ally of the American farmer. But like an addicted teenager, we have come to rely on subsidies, transfer payments and guarantees afforded by the government. Because of the many strings the government has attached to the "federal fix," we are inexorably tied to programs because we think we cannot survive without them.

Mr. Abele concludes with the following: "The international implications affecting agriculture, combined with federal policy and today's capital requirements and profit margins in agriculture, have drummed the death march for the traditional small family farmer in agriculture. Agriculture as it existed in the 30's, 40's and 50's is forever a thing of the past, unless our government is willing to mandate quotas, production restrictions, import restrictions and pay the huge subsidies consistent with those in many of the countries in the European Economic Community. But if we prefer to have market-oriented agriculture in a free capitalistic system, without increased economic barriers to trade, farms will continue to be fewer and larger. Heavily over-extended farmers and agricultural creditors will be victims of changes in policy and underlying economics."

At the heart of the Farm Credit System's liquidity crisis, and any proposed federal bailout, is the challenge of whether a move to a more free market agricultural system will ultimately be better for today's farmers (those who survive and those who are forced to take up a new livelihood) and the general economy than what we now have. Stop-gap salving of the status quo will only forestall the inevitable economic day of reckoning for many of this country's farmers and lenders. It is time to face facts, recognize that the pool of debt is already overflowing, and accept that as yet we have no real survivors.

FARM CREDIT SYSTEM TESTIMONY OF JOHN GILL

My name is John Gill. I am a grain farmer and seed processor in Platte County, Missouri. I am also a participant in the Agricultural Leadership of Tomorrow program sponsored by the University of Missouri. I would like to take this opportunity to express my views on the Farm Credit System crisis and how I think a bailout will affect the American economy and agriculture. I am sorry the Committee's schedule will not allow me to deliver this testimony in person and make myself available for questions.

Philosophically, I am against a Farm Credit System bailout. Government programs to expand agriculture, coupled with liberal lending practices by FCS offices, have put the FCS in the precarious state it is in. Commercial banks in rural areas are having the same type of problems and no one should seriously propose a federal infusion of cash to help their stockholders. The Farm Credit System has not been farsighted in its thinking. As recent as this summer, FCS officials were saying the system was financially sound. Now they are seeking a government handout to keep the system afloat.

Unfortunately, the costs to the economy are so high that a Farm Credit System bailout to some degree might be cheaper to U.S. taxpayers than letting the system dissolve. The best economic models from Wharton Econometric Institute and the Food and Agricultural Policy Research Institute at the University of Missouri have demonstrated the importance of agriculture on the U.S. economy. The studies coming out of these organizations are clearly showing the damaging effects of the Farm Credit crisis on GNP, employment, and interest rates.

There are several proposals being considered as to the FCS problem. Government guaranteed bonds are just another type of FCS bond and therefore not a reasonable solution. Nor is an interest rate buy-down. Many troubled farms are so heavily laden with debt that they will not cash flow even at a zero percent interest rate. These are simply bad loans that should not have been made in the first place. I am against a government organization buying foreclosed properties because of its lack of equity. Several private organizations have attempted to do the very same thing with private capital but have been stymied by laws in several midwestern states which outlaw corporate ownership of agricultural ground. To me, it is inequitable for the government to own farmland where it is illegal for private industry to do the same. Private industry could inventory this ground much more efficiently and effectively.

In my view, the Farm Credit System should receive federal funds only to the extent it is necessary to keep it a going concern in the short term. I am opposed to an extensive bailout which would make FCS interest rates competitive with commercial banks. The FCS must suffer to some degree for its past lending practices. However, consideration should be given to the effect on the financial markets where government agencies write bond issues with the implied full faith and backing of the U.S. Government. Along with any aid, the FCS should become subject to the same truth in lending, examinations, and audit requirements as commercial banks. This should serve to protect the Farm Credit System investors as well as the investment of the U.S. taxpayer.

The trend in the American agricultural market since the 1930's has been toward fewer and larger farms. Many government programs and much farm legislation have been enacted to stop this trend, so far with no success. It is my contention that we cannot afford to write legislation to effectively reverse this trend because of budget constraints. I might also add that we cannot in any event write legislation to thwart what market forces and technology are gradually bringing about in agriculture. A massive FCS bailout could only slow this trend for non-economically viable farming units and would only delay the inevitable bankruptcy of these farms. We are doing a disservice to these farmers and their families by stringing them along and putting them under continued stress.

If the United States Government must meddle in the affairs of agriculture, then the most effective thing it can do is balance the budget and learn to live within the parameters of its taxing capabilities. Some attention also needs to be given to federal grain standards. We hear of quality complaints from buyers of U.S. grain; without an economic incentive for farmers and grain dealers, our grain will not be clean.

In conclusion, a Farm Credit System bailout to some degree, and at some point in the future, may be an economic necessity -- not just for agriculture, but for the economy in general. Nevertheless, we should take this opportunity to reflect on the goals and actual results of farm legislation, as well as fiscal realities. American agriculture must learn to support itself because the U.S. government cannot afford to support small farms. In my view, we should see this as another reason to move government out of the agricultural business in a farsighted and orderly manner.

FARM CREDIT SYSTEM TESTIMONY OF TED ABELE

My name is Ted Abele. I have been a farmer with my family's third generation farm operation covering about fifteen hundred acres. I have served as a fieldman for a federal intermediate credit bank within the Farm Credit System, as a branch office manager for a local credit association within the system, and as a regional credit examiner with the Farm Credit Administration. I have a master's degree in agricultural economics and finance.

Presently, I am the president of American Agrinomics Management Co., Inc., a company providing financial, management and marketing consulting services primarily to commercial farmers, ranchers, and agribusinesses in seventeen (17) midwestern states and Canada. Many of my clients are currently in severely financially-stressed situations. Much of our company's work is directed toward helping farmers save struggling operations by debt negotiation, restructuring, reconveyance in lieu of foreclosure, partial liquidation, and the development of outside equity capital. American Agrinomics works with a broad spectrum of American agriculture and witnesses firsthand the social, financial, psychological and political ramifications of the massive contraction of the agricultural economy.

We are, at this time, experiencing the largest world surpluses of agricultural commodities in history. This is primarily because Third World country producers are a force in the world agricultural economy due to the United State's tremendous export of technology in the 1960s and 1970s. This was done, of course, to help the world feed itself; however, these nations learned more quickly than we expected. Countries like China, India, Argentina, Brazil, South Africa and many others are no longer importers of agricultural commodities, but are fast becoming this country's largest competitors in the world market. These countries have a significant relative advantage over American producers due to the structure of their agricultural economies, land costs, labor costs, and their stage of economic development. Another reason for the large world surplus is due to the fact that much of the world "need" is not recognized as "demand" because of the lack of purchasing power of many needy and starving nations.

One of the primary reasons behind the plight of the American agricultural economy is the lack of coordination between stated U.S. agricultural policy and the actual programs initiated to implement such policy. Agriculture is a very capital intensive industry, requiring long-term planning and significant stability. As an example, agricultural land purchases are generally capitalized over forty years. This is recognized by existing policy and programs affecting the agricultural economy. However, many programs presently on the board conflict with our stated policy. We desire adequate surplus food stocks and grain reserve, yet we also desire improved farm income and appear willing to do anything to improve income. We also contend that we desire a free market agricultural economy, yet we have initiated programs where price stability, income support, subsidized loan programs, and U.S. cargo shipping preferences take priority.

To improve the plight of the American agricultural economy, and with it the chances for a stable Farm Credit System, the Congress must structure agricultural programs so that they are farsighted, long-term and geared to allow agriculture to operate within the broad limits of a free market. Programs must be developed and structured to achieve the fulfillment of policy goals.

Agriculture can be free or it can be consistently profitable, but it cannot be both, for to be both is inconsistent with free market economics. Our federal government is not equipped to cope with the very broad range of problems inherent in agriculture because there are so many competing and contradictory interests at work in the dynamics of our agricultural economy. Though Congress often tries, it cannot please everybody. The basic reason behind the poor prices for agricultural commodities today is the United States' excess capacity. Agriculture in this country is overcapitalized, and pouring more money into a segment of the economy where the supply already exceeds the demand is not the solution. A prime illustration is the Farmers Home Administration, which in many instances has done a tremendous disservice to agriculture by supporting marginal and inefficient producers in an already overburdened economic sector. This makes as much sense as taxing interest receipts as a means of encouraging savings.

The Farm Credit System's financial crisis offers its own unique example of the overcapitalization of agriculture. Although there are dozens of educated estimates concerning the extent of the farm credit problem, many of the current estimates likely well understate the amount of "bad loans," or unserviceable debt, currently existing in the farm production sector. Due to the economic circumstances surrounding agriculture, it is reasonable to conclude that the amount of that unserviceable agricultural debt expands almost daily. Even the Farm Credit Administration's internal estimate of problem loans continues to grow almost geometrically as farm income decreases and farm asset prices continue to collapse. While much depends on the 1986 crop income, interest rates, the strength of the dollar, commodity prices, etc., it is highly probable that 35% to 40% of the Farm Credit System's (FCS) total loan portfolio will be classified as "problem loans" by late 1986. That means that the system will have a $25 billion bad loan total.

The Farmers Home Administration (FmHA) has about $25 billion in loans outstanding. More than two-thirds ($16.6 billion) are, would be, or will be nonperforming loans in 1986 if FmHA does not continue to make additional cash advances, arrange debt set aside, restructure and extend loan periods, and reduce interest rates as they have over the past five years. Ironically, despite all of these credit-easing policies employed by FmHA, there is no significant indication that the quality of credit or the debt serviceability of their farm borrowers has improved.

Commercial banks have approximately $50 billion in farm loans on the books. Nearly 80% of these loans are in the non-real estate category. We privately estimate that almost 30% ($15 billion) are likely troubled loans. With 93 bank failures to date in 1985, a 30% problem loan figure would not be difficult to substantiate.

Life insurance companies will have $2 billion to $3 billion in problem loans by late 1986, approximately 15% to 20% of their entire farm loan portfolio. With the collapse of farm land prices, these insurance companies will quickly recognize their increased exposure as farmers will more frequently opt for voluntary reconveyance or nonpayment and foreclosure as they realize that they are in possession of assets on which the debt exceeds the fair market value. (For example, no one reasonably tries to pay off a $25,000 debt on a 1980 Chevrolet. As the loan appreciably exceeds the asset's value, you simply allow the creditor to repossess the automobile or you voluntarily reconvey title and repurchase the same automobile on the open market for $2500.)

In summary, without including the $50 billion farm debt held by individuals, $60 - 70 billion in problem loans appears to be a highly realistic figure. That is nearly one-third of all farm debt. Losses of these amounts in the Farm Credit System and in the commercial banking sector will wreak havoc in the agricultural economy and commercial banking industry across the nation. $60 - 70 billion in debt defaults will have an unprecedented impact upon the U.S. economy as well.

Indeed, agriculture is an overcapitalized industry. By definition, when an industry is overcapitalized, supply exceeds demand and prices fall. When prices fall below average cost of production for an appreciable period of time, the underlying value of the assets used in production also collapse. This in essence is what is currently taking place in agriculture. Regardless of where the blame lies for the current situation in the agricultural economy, the price to be paid will be great, particularly if we opt to do nothing regarding the present farm crisis and allow the natural attrition in the free market to put huge numbers of farmers, agribusinessmen, rural banks, and others out of business along with the Farm Credit System.

However, it is unreasonable to assume that the federal government can or should even consider trying to salvage all of the financially-troubled farmers, agribusinessmen or commercial banks which currently have no reasonable likelihood of recovery. To pump billions of dollars into "saving the family farm" on an indiscriminate basis is to repeat the same blindfold approach that has proven disastrous with government credit institutions like FmHA. Any effort to bail out all the troubled farmers in the nation would not only be too financially burdensome, it would also be idealogically unacceptable. It would virtually prohibit failure in agriculture regardless of the deficiencies of management. The federal government does not have the financial resources, nor the obligation, to assure every farm creditor or farm producer success. An across the table bailout of financially-troubled farmers will issue a highly undesireable signal to every producer in every business, that being a federal free ride.

That approach would also penalize the farm producers who are better managers and who have worked themselves into a more favorable financial position.

There exists in agriculture today a mass of farmers who, although severely burdened by the difficult times in agriculture, do not endorse the mass infusion of government capital into agriculture or a broad bailout of every neighbor in financial trouble. The government, like a drug pusher in a school yard has never been a close and trusted ally of the American farmer. But like an addicted teenager, we have come to rely on subsidies, transfer payments and guarantees afforded by the government. Because of the many strings the government has attached to the "federal fix," we are inexorably tied to programs because we think we cannot survive without them.

The international implications affecting agriculture, combined with federal policy and today's capital requirements and profit margins in agriculture, have drummed the death march for the traditional small family farmer in agriculture. Agriculture as it existed in the 30's, 40's and 50's is forever a thing of the past, unless our government is willing to mandate quotas, production restrictions, import restrictions and pay the huge subsidies consistent with those in many of the countries in the European Economic Community. But if we prefer to have market-oriented agriculture in a free capitalistic system, without increased economic barriers to trade, farms will continue to be fewer and larger. Heavily over-extended farmers and agricultural creditors will be victims of changes in policy and underlying economics.

Solutions to the farm finance problem are all extremely expensive. But failure to address the problem will likely in the long run be much more expensive for the American economy and the American consumer. The most politically palatable solutions should be those which are indirect and geared to allow the gradual evolvement of a free market-oriented agriculture and an orderly liquidation of agricultural assets as those producers who cannot prove to be economically viable exit agriculture.

The Federal Land Bank, which holds 44% of all real estate debt, is caught in a vicious spiral. As there is a direct and inverse correlation between the cost of capital (Federal Land Bank rates) and land prices, as interest rates increase lower land prices result, leading to higher loan losses for institutions like the Federal Land Bank. This in turn causes higher FLB rates. To reduce loan losses and keep farmers who are in better financial positions from deserting the Farm Credit System ranks, the federal government could guarantee all or part of the Farm Credit bonds. In turn, investors would essentially be willing to accept T-bill and T-bond returns and Federal Land Bank and PCA rates could drop to 10 or 11 percent. This interest rate drop would in turn enhance some farmers' ability to service the debt and keep better quality lenders from deserting the farm credit ranks in favor of commercial bank rates.

An interest write down program, requiring commercial institutions to lend to current agricultural borrowers at the banks' cost of capital, would considerably reduce the cost of borrowing to certain producers, who could then service a greater portion of principal from the same cash flow. The federal government in turn would subsidize those loan rates up to 300 or 400 basis points to allow banks a reasonable profit for maintaining and servicing the existing loans. The subsidy should be minimal enough to keep banks from preferring agricultural loans (and thereby increasing the amount of dollars available to our already overcapitalized agriculture sector). Administrative responsibility must be left with the original borrowers. Such a program would necessitate banks' and farm credit institutions' continuing liquidation of a certain percentage of producers who could not operate under a reduced interest environment for the established 5 to 10 year period. This would slow the exodus of producers from agriculture and support the value of agricultural assets while improving loan portfolios. The second aspect of a reasonable write down plan would be the implementation of a so called "Aggie Mae" program, or tax exempt financing through a new agency that buys up bad loans from institutions and either rents back assets to producers with a repurchase option or commits those assets to long-term conservation programs geared toward the safeguarding of land and water resources.

The liquidation of agriculture interests, the devaluation of assets, and the failure of agribusiness and agricultural producers is a tragedy that may well have been averted with better government policies implemented by long-term agricultural programs. Still, an abrupt reversal of this "cleansing" process is neither economically feasible nor financially helpful for agriculture over the longer period of time. If we truly desire a free market system, realignment of asset values and product supply and demand will be necessary and healthy. Those of us closely involved with the broad area of agricultural producers and agribusinessmen throughout the nation will endorse a reasonable program geared to the easing of the current farm credit crisis, even to the extent of direct payment to agricultural entities, so long as it is aimed at treating the root causes of the current agricultural economic crisis rather than a prescription geared at treating the symptoms. Ultimately, farmers do not want a handout, they want an opportunity for a profit. Federal policy should be designed to allow a natural environment to evolve where those remaining farmers who have the economic means, the financial stamina and the professional management ability can benefit by receiving returns on their investment and management commensurate with other segments of the non-agricultural economy.

FARM CREDIT SYSTEM TESTIMONY OF DR. J. BRUCE BULLOCK

NATURE AND MAGNITUDE OF THE FARM FINANCE SITUATION

J. Bruce Bullock *

USDA reports published in March and July of this year and other surveys clearly document the existence of financial stress in U.S. agriculture. Close examination of data in these reports points out that the nature and magnitude of the farm financial situation is different than is generally recognized.

The increased frequency of farm loan delinquencies and bankruptcies is not caused by high interest rates, low commodity prices, or the high value of the dollar. Simply stated, the farm financial problem is that there is more farm debt than can be repaid. Throughout the 1970s farm debt increased annually by the amount of inflation in farm land values rather than at a rate dictated by growth in debt repayment capacity. Farm debt increased about three times as rapidly as net farm income. During the 1960-69 period, farm debt per dollar of net farm income averaged $2.96. Projections for 1985 indicate there is currently $9.87 of farm debt per dollar of net farm income.

Large portions of the increased debt were borrowed at double digit interest rates while rates of return on agricultural assets were less than 5 percent. The result is $50 billion of farm debt (over 20 percent of the total) that cannot be repaid from the combined farm and non farm income of the families that owe the debt.[1] Furthermore, the 20-50 percent decline in land values means that lenders will not be able to completely recover those outstanding loans through foreclosure and land sales.

The current situation was created by borrowers and all types of agricultural lenders being caught up in the wealth illusion created by the high rates of inflation during the 1970s. Land prices rose sharply during the last half of the 1970s reflecting continual increases in inflation expectations. A large number of land owners converted land inflation into debt capital as fast as land values increased. Unfortunately, repayment capacity from farm earnings never existed for a large part of the agricultural debt expansion over the past 10 years.

Borrowing money against inflated asset values when repayment capacity is not present makes sense only if inflation continues forever, or if the assets are sold at their inflated value (and the debt repaid) prior to termination of inflation. Obviously, neither of these developments occurred. Inflation was brought under control and caused the inevitable decline in land values. Land values established in 1981 made sense only if inflation continued at levels anticipated in 1981.

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* Professor and Chairman, Department of Agricultural Economics, University of Missouri-Columbia.

[1] The attached report (FAPRI #4-85) describes the procedure used to develop this and other estimates reported in this statement.

The decline in land values has had the obvious impact of consuming farmers' equity and hence their lenders' margin of collateral. However, the decline in land values has had no impact on the debt repayment capacity of the agricultural sector. Declining land values have simply removed the artificial impression of financial well being that both farmers and their lenders had been operating under over the past 10 years. Without the umbrella of inflation driven increases in land values to collateralize expanded debt to cover cash flow shortages, the agricultural sector is faced with rising delinquency rates on farm loans and increasing numbers of loan foreclosures and bankruptcies.

The symptoms of an excess debt situation are increasing in ability of borrowers to make interest and principal payments on schedule and a subsequent increase in foreclosures and bankruptcies. The observed rise in loan delinquencies has occurred simultaneously with record levels of real interest rates and substantial increases in the value of the U.S. dollar. Thus, government economic policies designed to bring inflation under control have been blamed for much of the financial problems in agriculture.

Viewing high interest rates and the strong value of the dollar as causes of the current farm finance situation has prevented most observers from looking beyond these factors in their search for the cause of the farm finance problem. Examination of the USDA data reveals that a substantial portion of the existing farm debt cannot be repaid even at zero interest rates or if farm product prices were increased by 50 percent. The problem is excess debt.

Policy Options and Their Potential Effectiveness

Several proposals for dealing with the farm finance situation have been advanced. Unfortunately, most of the proposals have focused on treating the negative cash flow and loan delinquency symptoms of the excess agricultural debt problem rather than with correcting the problem itself. Some of the most widely discussed proposals are examined below.

Higher Price Supports:

As I stated at the outset, the current financial problems of U.S. agriculture are too large to be solved by price and income support programs. Farm prices would have to increase from 15 to over 500 percent to correct the financial problems of the 386,000 farms with the most severe financial stress. Price increases of this magnitude are neither practical nor possible.

The farm finance problem will have to be dealt with separately from any consideration of agricultural price and income policy.

Interest Rate Buydowns:

Interest rate buydowns proposals are suggested on the grounds that rapid increases in interest rates caused by inappropriate fiscal and monetary policies make it impossible for farmers to service their debt. Focusing on high interest rates as the cause of the farm financial situation misses the real cause of the problem. Higher interest rates have certainly increased the cost of debt. However, interest rates are currently about one-third lower than they were during the last half of the 1970s when much of the farm debt was acquired. The problem is that farm debt is now over three times what it was in 1970. Farmers with serious financial problems would have almost as much trouble servicing these heavy debt loads at 1970 interest rates as with today's rates.

Examination of the USDA data reveals that the magnitude of farm debt swamps the impact of "high" interest rates for most farms experiencing financial stress. Reducing interest rates by 50 percent (100 percent in some cases) would not eliminate the cash shortfalls of farms with excess debt.

The USDA data also show that proposals to provide $3,000 to $5,000 in interest rate relief funds for farmers with debt problems are at best token efforts. Annual cash payments averaging at least $20,000 per farm are required to eliminate the cash shortfalls of the farmers under financial stress. Moreover, these payments would have to be made annually for several years into the future since no improvements in farm cash receipts is anticipated.

Debt Moratoriums:

Debt moratorium proposals basically treat the problem as being a temporary income shortfall. The assumption is that farm income will be high enough next year to solve the financial problems of the borrower. These proposals ignore the cause of the problem.

Most proposals for debt moratoriums do not explicitly state who is to absorb the cost of providing the moratoriums. Indeed, most debt moratoriums proposals do not seem to recognize that there are costs associated with the debt moratorium. One option is to have the borrower pay the cost of amortizing the unpaid principal and interest into the borrower's debt. This solution expands the borrower's debt and makes no sense, if the problem is already too much debt. The second option is to have the lender absorb the cost of the moratorium. This seems to be the option implied by most debt moratorium proposals. However, this option simply passes a large part of the cost on to other borrowers in the form of higher interest rates or to stockholders of the lending institution. Thus, debt moratoriums either compound the problem of the borrower or transfer the cost of the moratorium to third parties. Neither option helps solve the basic problem.

Provide Government Loan Guarantees:

One thing must be kept in mind as this policy option is considered. Government loan guarantees do not increase the repayment capacity of farmers with financial problems. A loan guarantee program will successfully deal with the financial stress problem only if the program requires that the excess debt situation of the borrower be corrected as a pre condition for obtaining the loan guarantee. Failure to impose such requirements will simply mean that the unavoidable wealth losses required to correct the excess debt problem will be transferred from borrowers and lenders to the government. This is certainly a viable policy option. However, it should be recognized as a loss transfer mechanism.

Expand Government Loan Programs:

More credit, even at subsidized interest rates, is not the solution to an excess debt problem. An expanded government loan program is the worst possible policy that could be pursued. Providing additional debt to these farmers is analagous to putting more water in the swimming pool in an attempt to save a person observed to be drowning in water over their head. More debt is not the solution to an excess debt problem.

A strong case can be made that liberal government lending policies promulgated by Congress through FmHA has already compounded rather than eased the farm credit problem. FmHA provided 34 percent of the increase in farm non real estate debt during the 1979-82 period. As a result, FmHA market share of non real estate farm debt increased from 3 percent in 1973 to 15 percent in 1983.

A good portion of the increased FmHA debt was for disaster loans. Disaster loans simply add to the disaster of farms that already have more debt than can be repaid. Borrowed funds can profitably be used only on investments that yield a return higher than the interest rate at which the funds were borrowed. Payment of last year's production expenses from funds borrowed in lieu of a failed crop produce no return on investment. There is a genuine need for farm programs to provide mechanisms for disaster relief. However, this disaster relief must take the form of indemnity payments from insurance to avoid doing more harm than good in providing farmers with money to deal with the disaster.

Add Liquidity to the Land Market:

One proposal is to create an agency to purchase land. The actions of the agency would provide strength and liquidity to the land market. The agency would then lease the land back to the farmer so that the farming operation could be continued. Presumably the land purchase agency would expect to receive a competitive rate of return on funds invested in land purchases. Thus, if land is purchased at a price equal to the debt of the selling farmer, the lease payments would be about the same as the interest payments the farmer is currently making on the debt he transferred with the land. The net effect is that the borrower transfers title to his land to the agency in return for making no principal payments.

The land purchase proposal does deal directly with the problem of excess debt. It removes the burden of principal payments from the farmer. But, it does not remove interest payment obligations. This proposal would remove cash fall shortfalls for about 20 percent of the highly leveraged farms. The remaining farms would still have several thousand dollars in annual cash shortfalls.

Debt Removal:

Solution to the excess debt problem requires that the debt and associated principal and interest payments be removed from the agricultural balance sheet and cash flow. There is approximately $50 billion in excess debt. Thus, the debt could be removed by either a $50 billion debt write off by lenders, by a $50 billion government pay off of farm debt or by a $50 billion combination of asset transfers from borrowers to lenders and loan write offs by lenders. The policy choice then is how these losses are to be distributed between lenders, borrowers, and the government.

The government is going to be an important part of the solution in each of the options listed above. The government holds about $25 billion of the excess debt in the form of FmHA loans. Since FmHA is by law the lender of last resort, a very high proportion of its portfolio is almost certainly in the "impossible to repay" category. Thus, the government holds about one-half of the excess agricultural debt.

Do Nothing:

One option is to simply let the chips fall where they may. This will mean that the wealth losses will be shared between borrowers and lenders. Unless lenders and borrowers move quickly to cut their losses and get debt into line with repayment capacity, the magnitude of the problem and the cost of adjustment will continue to grow.

A do nothing government program will result in a substantial transfer of asset ownership from borrowers to lenders to remove the debt and a substantial increase in land sales. Forcing the complete adjustment to occur through land sales will generate additional declines in land values. Further declines in land values may occur regardless of the policy selected. However, a do nothing policy could cause an over reaction in land prices in the short-run.

A do nothing policy is workable. The market will adjust. The results will include a substantial increase in the number of loan foreclosures and farm bankruptcies. It will also result in a substantial increase in the number of agricultural lender failures. Both agriculture and the lending industry can survive a do nothing policy. However, a do nothing policy will result in major structural changes in both industries. Moreover, the impacts of these structural changes will spill over into main street of rural communities across the U.S. Policy makers will have to decide if these changes are an acceptable price to pay for the solution to the farm finance problem.[2]

Observations

There is a serious financial problem in agriculture. Over 20 percent of existing farm debt cannot be repaid.

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[2] The attached FAPRI Staff Report #9-85 provides an estimate of the economic impact of a do nothing policy.

The magnitude of the farm debt problem requires large scale and immediate action if we are to minimize the adverse side effects of adjustments to the current situation. There are no satisfactory partial solutions. There is no way of avoiding the wealth transfers and losses associated with the creation of excess debt and the asset devaluations that have occurred. The challenge facing policy makers is to determine how these losses are to be distributed among borrowers, lenders, and taxpayers.

One thing is clear. A policy decision should be made quickly. If the decision is to do nothing, then lenders and borrowers must immediately initiate the adjustment to minimize losses. Failure to recognize the losses and to terminate the growing debt service obligations associated with the excess debt simply compounds the problem. Similarly, if there is to be relief in the form of a government program, it should be implemented as soon as possible to terminate the losses and the disruption caused by the current situation.

FARM CREDIT SITUATION: IMPLICATIONS FOR AGRICULTURAL POLICY

FAPRI #4-85

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SUMMARY
FARM CREDIT SITUATION: IMPLICATIONS FOR AGRICULTURAL POLICY

J. Bruce Bullock

The nature and magnitude of the farm financial situation is different than is generally recognized. The increased frequency of loan delinquencies and bankruptcies are not caused by high interest rates and the strong value of the dollar. The current financial problems were created by the annual increases in farm debt throughout the 1970s by the amount of increases in asset values rather than at a rate dictated by growth in repayment capacity. Moreover, this debt was borrowed at double digit interest rates while rates of return on agricultural assets were less than 5 percent. The result is $50 billion of farm debt (about 20 percent of total) that cannot be repaid from the combined farm and non farm income of the families that owe the debt.

There are several policy implications of the excess agricultural debt situation.

- The magnitude of the farm finance problem makes traditional price support programs ineffective for dealing with the problem. Commodity prices would have to be increased by more than 50 percent to help most of the financially stressed farms.
- The magnitude of farm debt swamps the impact of "high" interest rates for most farms experiencing financial stress. Reducing interest rates by 50 percent (100 percent in some cases) would not eliminate the cash shortfall of farms with excess debt.
- Government loan guarantees do not increase repayment capacity of farms with financial stress. Thus, loan guarantee programs do not effectively deal with the financial problem.
- More debt, even at subsidized interest rates, is not the solution to an excess debt problem. An expanded government loan program is the worst possible policy that could be pursued.

The magnitude of the farm debt problem requires large scale and immediate action. There is no way of avoiding the wealth transfers and losses associated with the creation of excess debt and the asset devaluations that have occurred. The challenge facing policy makers is to determine how these losses are to be distributed among borrowers, lenders, and the government.

FARM CREDIT SITUATION: IMPLICATIONS FOR AGRICULTURAL POLICY*

J. Bruce Bullock**

It is widely recognized that there is a considerable amount of financial stress in the agricultural sector. A USDA report released last week provides us with a comprehensive look at the extent and distribution of financial difficulties in U.S. agriculture.[1] The report indicates that about 18 percent of the farms in the U.S. owe 56 percent of all farm debt. These 386,000 farms are considered to be highly leveraged and have less than 60 percent equity in their farm businesses. The USDA estimates that by January 1986, about six percent of U.S. family size commercial farms will be technically insolvent (i.e., have negative net worth). They also estimate that if current economic conditions extend into the future, an additional 2.8 percent of family farms will become insolvent each year.

Simply stated, the farm financial problem is that there is more farm debt than can be repaid from farm and non farm income of those who owe the debt. High interest rates and the strong value of the dollar tend to compound the pressures created by the excess debt situation. However, high interest rates and weak export demand are not the cause of the financial problems in agriculture.

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[1] USDA, "The Current Financial Conditions of Farmers and Farm Lenders," Economic Research Service, Agricultural Information Bulletin No. 490, March 1985.

The symptoms of an excess debt situation are increasing inability of borrowers to make interest and principal payments on schedule and a subsequent increase in loan foreclosures and bankruptcies. The observed rise in loan delinquencies has occurred simultaneously with record levels of real interest rates and substantial increases in the value of the U.S. dollar. Thus, government economic policies designed to bring inflation under control have been blamed for much of the financial problems in agriculture. Unfortunately, most of the policy proposals for dealing with the farm finance situation have focused on treating the negative cash flow and loan delinquency symptoms of the excess agricultural debt problem rather than with correcting the problem itself.

Viewing high interest rates and the strong value of the dollar as causes of the current farm finance situation has prevented most observers from looking beyond these factors in their search for the cause of the farm finance problem. Examination of the USDA data clearly reveals that a substantial portion (perhaps as much as 24 percent) of the existing farm debt cannot be repaid even at zero interest rates or if farm product prices were increased by 50 percent. Consequently, the difficult question facing policy makers is how the inevitable wealth losses are to be distributed among farmers, lenders, and the government.

Four questions regarding the current farm finance situation are of interest from a public policy perspective:

1. How did we get into the current situation?

2. What is the cause (not the symptoms) of the current financial stress in U.S. agriculture?
3. What are the policy options available for dealing with the problem?
4. What are the likely impacts of these policy options?

How did we get here?

The agricultural sector financed its trip to the current situation on borrowed capital. Unfortunately, repayment capacity from farm earnings never existed for a large part of the agricultural debt expansion over the past 10 years. Table 1 shows that the rate of return on farm assets was less than 5 percent throughout the 1970s when much of the increases in farm debt occurred. Moreover, the return has been less than three percent since 1980. Clearly, asset values were increasing more rapidly than farm income over this period. The current financial problems were created because debt expanded annually by the amount of increases in asset values rather than at the rate dictated by growth in repayment capacity. Moreover, this debt was borrowed at double digit interest rates while rates of return on agricultural assets were less than 5 percent.

Borrowing money against inflated asset values with inadequate earning capacity for debt repayment makes sense only if inflation continues forever, or if the assets are sold at their inflated value (and the debt repaid) prior to termination of inflation. Obviously, neither of these developments occurred. Inflation was brought under control and caused the inevitable decline in land values. Land values established in 1981 made sense only if inflation continued at levels anticipated in 1981.

TABLE 1

KEY INDICATORS OF CHANGES IN ECONOMIC HEALTH OF U.S. AGRICULTURAL SECTOR

	Net Farm Income Bill $	Value of Farm Assets Bill $	Farm Debt Bill $	Incomes as % of Asset Value	Debt Asset Ratio	Farm Debt ÷ Net Farm Income
1940-49	11.8	90.3	9.45	13.1	.11	.80
1950-59	12.8	171.5	17.3	7.5	.10	1.35
1960-69	12.4	247.4	36.7	5.0	.15	2.96
1970-79	23.6	521.9	83.7	4.5	.16	3.55
1980	21.2	1005.5	159	2.1	.15	7.50
1981	31.0	1089.8	175	2.8	.16	5.65
1982	22.3	1083.5	202	2.1	.19	9.05
1983	16.1	1045.2	216	1.5	.21	13.42
1984[1]	31	1031.1	215	3.0	.21	6.94
1985[2]	22	NA	217			9.87

[1] preliminary

[2] forecast

The decline in land values has had the obvious impact of consuming farmers' equity and hence their lenders' margin of collateral. Consequently, the debt/asset ratios of farm borrowers have increased and the quality (as measured by collateral margin) of the lenders' agricultural loan portfolio has declined.

However, the decline in land values has had no impact on the debt repayment capacity of the agricultural sector. Declining land values have simply removed the artificial impression of financial well being that both farmers and their lenders had been operating under for the past 10 years. Without the umbrella of inflation driven increases in land values to collateralize expanded debt to cover cash flow shortages, the agricultural sector is faced with rising delinquency rates on farm loans and increasing numbers of loan foreclosures and bankruptcies.

What is the Cause of the Current Financial Stress?

The data in Table 1 indicate that excess debt is the cause of the current financial stress in agriculture. Excess debt refers to debt that cannot be repaid from income generated by the asset purchased with borrowed capital. However, not everyone is convinced that excess debt is the problem. Some argue that high interest rates are the culprit.

The data in Tables 2 and 3 clearly demonstrate that the magnitude of farm debt swamps the impact of "high" interest rates for most farms experiencing financial stress. Note that reducing interest rates 50 percent (100 percent in some cases) would not eliminate the cash shortfall of farms with excess debt. It is also clear from the data in

TABLE 2

AVERAGE DEBT SERVICE OBLIGATIONS AND CASH SURPLUS (SHORTFALL) FOR FARMS WITH DEBTS EXCEEDING 70 PERCENT OF ASSET VALUES 1983

Sales Class $1,000	Principal Payment	Interest Payment	Cash Surplus (Short Fall)
> 500	$59,671	$119,674	(56,456)
250-499.9	26,348	61,691	(5,510)
100-249.9	15,905	29,679	(21,592)
50-99.9	10,347	17,509	(21,606)
25-49.9	7,294	12,610	(24,689)
10-24.9	3,736	12,839	(28,064)
< 10	2,650	4,835	(11,369)

Source: USDA, "The Current Financial Condition of Farmers and Farm Lenders," Economic Research Service, Agri. Info. Bulletin, No. 490, March 1985, Appendix Table 1.

TABLE 3

AVERAGE DEBT SERVICE OBLIGATIONS AND CASH SURPLUS (SHORTFALL) FOR FARMS WITH DEBTS RANGING FROM 40 TO 70 PERCENT OF ASSET VALUES, 1983

Sales Class $1,000	Principal Payments	Interest Payments	Cash Surplus (Short Fall)
> 500	$52,600	$108,533	$6,978
259-499.9	21,074	48,201	7,222
100-249.9	14,323	32,996	(4,840)
50-99.9	9,892	23,223	(22,443)
25-49.9	5,071	11,864	(21,056)
10-24.9	3,736	7,690	(22,405)
< 10	2,585	5,419	(14,604)

Source: USDA Agri. Info. Bulletin No. 490, March 1985, Appendix Table 1.

Tables 2 and 3 that proposals to provide up to $3,000 or $4,000 in interest rate relief funds for farmers with debt problems are at best token efforts. Cash payments averaging at least $20,000 per farmer are required to eliminate the cash short falls of the farmers under financial stress. Moreover, these payments would have to be made annually for several years into the future since no improvement in farm cash receipts is anticipated.

Policy Options and Their Potential Effectiveness

Higher Price Supports:

Raising price support levels is the old standby solution for dealing with farm finance issues. Many farmers and other observers seem to think that higher farm commodity prices will cure any problem facing agriculture. However, the data in Table 4 show that these observers are kidding themselves about the capacity of higher support prices to solve the current financial problems in agriculture. The data show the cash surplus (shortfall) of farms in each size/debt category as a percent of gross farm sales. Farm prices would have to be increased from 15 to 560 percent to correct the financial problems for most of the 386,000 farms with the most severe financial stress.

Price increases of this magnitude generated by price support programs are neither practical nor possible. The current financial problems of U.S. agriculture are too large to be solved by price and income support programs.

TABLE 4

AVERAGE CASH SURPLUS (SHORTFALL) AS A PERCENT OF CASH SALES BY SALES CLASS AND DEBT/ASSET RATIO 1983

Sales Class $1,000	Debt Asset Ratio		
	Over .7	From .4 to .7	Less than .4
> 500	(5.2)	.7	14.1
250-499.9	(1.8)	2.2	13.9
100-149.9	(14.7)	(3.3)	10.3
50-99.9	(32.5)	(31.8)	(2.0)
25-49.9	(72.9)	(61.1)	(23.7)
10-24.9	(211.3)	(150.2)	(44.2)
< 10	(567.9)	(499.8)	(144.0)

Source: USDA Agricultural Information Bulletin No. 490.

Provide Government Loan Guarantees:

Policy makers should keep one thing in mind as they consider this policy option. Government loan guarantees do not increase the repayment capacity of farmers with financial problems. A loan guarantee program will successfully deal with the financial stress problem only if the program requires that the excess debt situation of the borrower be corrected as a pre condition for obtaining the loan guarantee. Failure to impose such requirements will simply mean that the unavoidable wealth losses required to correct the excess debt problem will be transferred from borrowers and lenders to the government (assuming the government does not confiscate the assets of the defaulting borrower). This is certainly a viable policy option. However, it should be recognized as a loss transfer mechanism.

Proponents of the loan guarantee program point to the government bail out of Chrysler Corporation as an example of how this approach has been successful elsewhere in the economy. However, the Chrysler loan guarantee program simply provided the company with an opportunity to get its internal organization and operation into shape for operating in the new economic environment in which it found itself. Is the agricultural sector willing to make similar changes?

Add Liquidity to the Land Market:

One proposal is to create an agency to purchase land. The actions of the agency would provide strength and liquidity to the land market. The agency would then lease the land back to the farmer so that the farming operation could be continued. Presumably the land purchase agency would expect to receive a competitive rate of return on funds invested in land purchases. Thus, if land is purchased at a price equal to the debt of the selling farmer the lease payments would be about the same as the interest payments the farmer is currently making on the debt he transferred with the land. The net effect is that the borrower transfers title to his land to the agency in return for making no principal payments.

The average principal payments of farmers under financial stress are shown in Tables 2 and 3. The land purchase/lease back agency would completely solve the cash short fall problems only for farms over $250,000 gross sales with less than 30 percent equity and for farms with over $100,000 sales and equity between 30 and 60 percent. This accounts for about 21 percent of the highly leveraged farms. The remaining farms would still have several thousand dollars in annual cash short falls.

The land purchase proposal does deal directly with the problem of excess debt. It removes the burden of principal paymentsfrom the farmer, but does not remove interest payment obligations.

Debt Removal:

Solution to the excess debt problem requires that the debt and associated principal and interest payments be removed from the agricultural balance sheet and cash flow. Public policy will determine how this wealth loss is distributed among borrowers, lenders, and the government.

How much excess debt is there? The USDA estimates of cash shortfall provide the basis for determining the amount and distribution of excess debt in the agricultural sector assuming that farm production, commodity prices, and off farm earnings of farm families remain at 1983 levels.

The USDA cash flow analysis assumed that principal payments are 1/20 of the existing debt. Thus, if we use 10 percent interest rates, annual principal and interest payments are $150 per $1000 of debt. This estimate of debt servicing cost is used to calculate the amount of debt that must be removed in order to reduce the cash shortfall to zero.

The first two columns of Table 5 show the average debt per farm in each category. The second two columns show the amount of debt that would have to be removed in order to reduce the average farmer's cash shortfall to zero. The last two columns show the percent of debts that would have to be removed.

Table 6 shows the total amount of debt owed by farms in the financially stressed category. Table 7 shows the total amount of excess debt for each group of farms. There is approximately $50 billion of agricultural debt that cannot be paid from current income (both farm and non farm sources) of farmers owing that debt. This is 23.5 percent of the total debt owed by the agricultural sector.

Three fourths of the excess debt is held by farms producing less than $100,000 in annual gross sales. Forty-five percent of the debt is owed by farms with less than $50,000 annual sales.

The USDA cash shortfall data clearly reveal the inappropriateness of including farms with less than $50,000 annual sales in our calculations of farm numbers used in formulating agricultural policies. Note in Table 5 that more than 100 percent of the debt owed by these farms would have to be written off to generate a zero cash balance for these

TABLE 5

AVERAGE DEBT AND AMOUNT OF DEBT WRITE OFF REQUIRED TO REDUCE CASH SHORT FALL TO ZERO

Sales Class	Average Debt		Debt Forgiveness Required		Percent of Debt That Must Be Forgiven	
	DA < .7	.4 < D/A <.7	D/A ≥ .7	.4 < D/A < .7	D/A ≥ .7	.4 < D/A < .7
	----------$1000--------		------------$1000----------		---------Percent---------	
> 500	1,195	1,074	376	------	31	------
250-499.9	586	461	37	------	6	------
100-249.9	303	315	144	32	48	10
50-99.9	165	220	144	150	78	68
25-49.9	132	112	165	140	125	125
10-24.9	110	76	187	149	170	196
≤ 10	49	53	76	97	155	183

TABLE 6

AMOUNT OF DEBT OWED BY FARMS WITH DEBT ASSET RATIOS IN EXCESS OF .4

Sales Class ($1000)	Amount of Debt (Bill. $)			Percent of Total Farm Debt		
	D/A > .7	.4 < D/A < .7	Total	D/A > .7	.4 < D/A < .7	Total
> 500	10.4	10.2	20.6	4.9	4.8	9.7
250-499.9	8.9	10.8	19.7	4.2	5.1	9.3
100-249.9	12.5	22.4	34.9	5.9	10.6	16.5
50-99.9	8.3	13.1	21.4	3.9	6.2	10.1
< 50	10.2	12.3	22.5	4.8	5.8	10.6
All Farms	50.3	68.8	119.5	23.7	32.5	56.2

TABLE 7

AMOUNT OF DEBT WRITE OFF REQUIRED TO REMOVE CASH SHORTFALLS

Sales Class $1,000	Amount of Write Off Required ($ Bill.)			Percent of Total Write Off	Write Off as A Percent of Total Farm Debt		
	D/A > .7	.4 < D/A < .7	Total		D/A > .7	.4 < D/A < .7	Total
> 500	3.2	—	3.2	6	1.5	—	1.5
250–499.9	0.5	—	0.5	1	.2	—	0.5
100–249.9	6.0	2.2	8.2	17	2.8	1.0	3.9
50–99.9	6.5	8.9	15.4	31	3.1	4.2	7.3
< 50	10.2	12.3	22.5	45	4.8	5.8	10.6
All Farms	26.4	23.4	49.8	100	12.5	11.0	23.5

TABLE 8

AVERAGE GROSS FARM INCOME MINUS OPERATING EXPENSES (EXCLUDING INTEREST) BY FARM SIZE FOR FARMS WITH DEBTS IN EXCESS OF 70 OF ASSET VALUES

Sales Class $1000	Gross Sales	Operating Expenses	Net Contribution of Farm Operation to Cash Flow
	Dollar Per Farm		
> 500	1,141,608	1,026,386	115,224
250–499.9	337,463	248,336	89,127
100–249.9	155,350	122,680	32,670
30–99.9	72,653	56,718	15,935
25–49.9	36,769	33,603	3,166
10–24.9	16,481	23,621	(7,140)
< 10	9,432	12,880	(3,448)

Source: USDA Agricultural Information Bulletin 490, Appendix Table 1.

farms. These farms have cash flow problems unrelated to their debt structure.

Tables 8 and 9 show that the average farm producing less than $25,000 of gross agricultural sales generates about a $6,000 drain on cash flow even before debt payments are considered. Providing debt to these "farming" operations is hardly good business. Table 10 illustrates that if public policy is to maintain these families in rural areas with a standard of living comparable to commercial farmers, we would be better off to shut down their farming operation. The amount of compensation required in addition to 100% debt write off arises because the off farm income of these families is less than the amount of living expenses used in the USDA calculations.

Expand Government Loan Programs:

More credit, even at subsidized interest rates, is not the solution to an excess debt problem. An expanded government loan program is the worst possible policy that could be pursued. Providing additional debt to these farmers is analagous to putting more water in the swimming pool in an attempt to save a person observed to be drowining in water over their head.

A strong case can be made that liberal government lending policies promulgated by Congress through FmHA has already compounded rather than eased the farm credit problem. Government lending programs have provided 20 percent of the growth in non real estate farm debt over the past 12 years. Table 11 shows that FmHA operating loans increased 70 percent in 1976. This was followed by annual increases of more than 50 percent over the 1978-80 period. FmHA provided 34 percent of the

TABLE 9

AVERAGE GROSS FARM INCOME MINUS OPERATING EXPENSES (EXCLUDING INTEREST) BY FARM SIZE FOR FARMS WITH DEBTS RANGING FROM 40 TO 70 PERCENT OF ASSET VALUES

Sales Class $1000	Gross Sales	Operating Expenses	Net Contribution of Farm Operation to Cash Flow
	Dollars Per Farm		
> 500	1,056,994	896,548	160,446
250-499.9	340,040	257,215	82,825
100-249.9	157,949	106,784	51,165
50-99.9	76,157	55,800	20,357
25-49.9	38,236	34,406	3,830
10-24.9	16,494	23,128	(6,630)
< 10	4,176	10,330	(6,154)

Source: USDA Agricultural Information Bulletin 490, Appendix Table 1.

TABLE 10

ANNUAL CASH PAYMENTS IN ADDITION TO 100% DEBT WRITE OFF REQUIRED FOR ZERO CASH SHORTFALL

	If Farming Operation Is Continued		If Farming Operation Is Terminated		Off Farm Income Minus Median Non Farm Family Income 1983*
Class	D/A ≥ .7	.4 < D/A < .7	D/A ≥ .7	.4 < D/A < .7	
25-49.9	$ 4,950	$ 4,200	$8,116	$8,030	$-7,951
10-24.9	11,500	10,944	4,360	4,313	-4,349
≤ 10	4,042	6,598	594	444	- 436

*The USDA calculations of cash surplus (shortfall) estimated family living expenses as the 1983 median family income for non metropolitan counties ($20,938).

TABLE 11

ANNUAL INCREASE IN NON REAL ESTATE DEBT OUTSTANDING FROM PREVIOUS JANUARY 1, 1973-1984

Year	Banks	PCA	FHA	Individual and Others*	Total Excluding CCC
	-----	-----	-Percent-	-----	-----
1973	14	9	1	9	11
1974	20	18	12	14	18
1975	6	21	19	10	11
1976	12	13	70	13	11
1977	15	13	6	17	15
1978	10	10	67	23	15
1979	10	11	84	17	16
1980	10	21	55	16	18
1981	2	9	31	6	8
1982	4	7	23	6	8
1983	10	(4)	2	4	4
1984[3]	8	(7)	(1)	(6)	1

[3] Preliminary

*Includes SBA

Source: USDA, Economic Indicators of the Farm Sector increase in farm non real estate debt during the 1979-82 period (Tables 12 and 13). FmHA market share of non real estate farm debt increased from 3 percent in 1973 to 15 percent in 1983 (Table 14).

A good portion of this debt was for disaster loans. Disaster loans simply add to the disaster of farms that already have more debt than can be repaid. Borrowed funds can profitably be used only on investments that yield a return higher than the interest rate at which the funds were borrowed. Payment of last year's production expenses from funds borrowed in lieu of a failed crop produce no return on investment. There is a genuine need for farm programs to provide mechanisms for disaster relief. However, this disaster relief must take the form of indemnity payments from insurance to avoid doing more harm than good in providing farmers with money to deal with the disaster.

Do Nothing:

One policy option is to simply let the chips fall where they may. This will mean that the wealth losses will be shared between borrwers and lenders. Unless lenders and borrowers move quickly to cut their losses and get debt into line with repayment capacity, the magnitude of the problem, and the cost of adjustment will continue to grow.

A do nothing government program will result in either a substantial transfer of asset ownership from borrowers to lenders to remove the debt and/or a substantial increase in the amount of land sales. Land prices have already fallen 10 to 28 percent in the midwest. Forcing the complete adjustment to occur through land sales will generate additional declines in land values. Further declines in land values may occur regardless of the policy selected. However, a do nothing policy is

TABLE 12

SOURCES OF INCREASES IN FARM NON REAL ESTATE DEBT 1973-1984

	Amount of Increased Debt Provided				
Period	Banks	PCA	FHA	Individual	Total
	1000 dollars				
1973-1976	5,523	3,945	873	2,491	12,832
1976-1979	7,667	3,993	3,527	5,629	20,816
1979-1982	4,583	5,892	7,632	4,393	22,500
1982-1984	5,812	(2,188)	170	162	2,956
1973-1984	23,585	11,642	12,202	12,675	60,104

Source: USDA Economic Indicator of Farm Sector

TABLE 13

PERCENT OF TOTAL INCREASE IN NON REAL ESTATE DEBT ACCOUNTED FOR BY LENDER

	Percent of total Provided				
Period	Banks	PCA	FHA	Individuals	Total
1973-76	43	31	7	19	100
1976-79	37	19	17	27	100
1979-82	20	26	34	20	100
1982-84	150	(58)	4	4	100
1973-1984	39	19	20	21	100

Source: USDA Economic Indicators of Farm Sector

TABLE 14

LENDER MARKET SHARES FOR FARM NON REAL ESTATE DEBT SELECTED YEARS

Year	Banks	PCA	FHA	Individual and Other
	Percent			
1973	51	24	3	22
1978	46	25	5	23
1983	40	22	15	22

Source: USDA Economic Indicators of Farm Sector likely to cause an over reaction in land prices in the short run.

A do nothing policy is workable. The market will adjust. The results will include a substantial increase in the number of loan foreclosures and farm bankruptcies. It will also result in a substantial increase in the number of agricultural bank failures. Both agriculture and the lending industry can survive a do nothing policy. However, a do nothing policy will result in major structural changes in both industries. Moreover, the impacts of these structural changes will spill over into mainstreet of rural communities across the U.S. Policy makers will have to decide if these changes are an acceptable price to pay for the solution to the farm finance problem.

Conclusions

There is clearly a serious financial problem in U.S. agriculture. The problem is about $50 billion of farm debt that cannot be repaid from the combined farm and non farm income of the families that owe the debt.[2] This accounts for about 23 percent of the total debt held by the agricultural sector.

The magnitude of the excess farm debt problem requires large scale and immediate corrections. There are no satisfactory partial solutions. Failure to correct the problem will completely consumer the equity of farmers holding the excess debt. Furthermore, failure to correct the problem will also seriously impact the economic viability of financial institutions currently providing credit to agricultural producers.

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[2] The estimates of excess debt derived from the USDA data are probablv upper bound estimates. However, if the USDA data and/or these calculations are over estimated by 50 percent, there is a substantial excess problem to be dealt with.

There is no way of avoiding the wealth transfers and losses that have occurred from creation of the excess debt and the asset devaluations that have occurred. Failure to recognize the losses and to terminate the growing debt service obligations associated with the excess debt simply compounds the problem.

The challenge facing policy makers is to determine how those losses are to be distributed among borrowers, lenders, and the government.

The government holds about $25 billion of the excess debt in the form of FmHA loans. Since FmHA is by law the lender of last resort, a very high proportion of its portfolio is almost certainly in the "impossible to repay" category. Thus, one step of the adjustment process might be to terminate FmHA lending operations and forgive all outstanding FmHA farm loans. This would eliminate about one-half of the excess debt.

High interest rates are not the cause of the problem. Thus, efforts to subsidize interest rates to farm borrowers is not an appropriate policy response. Moreover, the problem is so large that interest rate subsidies provide only insignificant, partial relief to the symptoms of the excess debt problem.

The magnitude of the excess debt problem also renders price support policies ineffective as a solution. The farm finance problem must be dealt with separately from price and income policies. Moreover, the finance problem should be dealt with before price and income policies of the 1985 farm bill are developed.

One thing is clear. A policy decision should be made quickly. If the decision is to do nothing, then lenders and borrowers must immediately initiate the adjustment to minimize losses. Similarly, if there is to be relief in the form of a government program, it should be implemented as soon as possible to terminate the losses and the disruption caused by the current situation.

Summary Report:

Economy-Wide Impacts of the Farm Financial Crisis

FAPRI Staff Report #9-85 (Revised)
July 1985

Contributors

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EXECUTIVE SUMMARY

The financial condition of U.S. agriculture is in a state of crisis; and the deterioration will not abate under most of the 1985 Farm Bill options being considered by Congress. Moreover, the financial crisis in agriculture, if not altered by corrective actions alleviating the debt load of highly leveraged farmers, will reach a magnitude sufficient to affect U.S. financial markets and the performance of the national economy.

Major results of this summary report, linking a Farm Journal survey and FAPRI farm income projections to farm loan losses and the Wharton Econometric model of the U.S. economy are:

- Farms with debt-to-asset ratios of 40 percent and over hold approximately $140 billion of the $210.8 billion total U.S. farm debt. Farms with 40 percent or larger debt-to-asset ratios are likely to experience financial stress.

- The farm-debt situation is especially serious for younger farmers residing in the Central region of the U.S. The average debt-to-asset ratio for these farms is 20 percentage points above the national average.

- The surplus capacity situation for U.S. agriculture makes it unlikely that net farm income can be increased beyond $20 to $25 billion without high government cost. Over the period 1987-1990, direct government costs of $6 to $7 billion annually will be required to hold these farm income levels. If government support programs were removed, net farm income would likely drop by 40 percent during the subsequent three years.

- Annual principal and interest shortfalls on loan losses with net farm income in the $15 to $25 billion range and continued high real interest rates are projected at about $5 to $10 billion.

- Liquidation of 10 to 17 percent of farm assets and 35 to 50 percent of the debt would be required to service the remaining debt. This asset liquidation rate is three to four times the volume historically flowing through farm asset markets.

- Under current farm income conditions with preemptive measures to address the farm financial crisis, loan losses resulting from farm bankruptcies would be contained at about $10 billion and would have relatively small effects on the U.S. economy.

- If current farm income conditions prevail, and no financial assistance measures are initiated, or financial programs are offered but commodity support programs are eliminated, the loan losses could rise sharply to $20 to $25 billion.

- Loan losses of $20 to $25 billion are expected to increase short term interest rates by 75 to 125 basis points, reduce national employment by 175,000 to 275,000 jobs, reduce total GNP by $30 to $50 billion over eight years, and increase the federal debt by $14 to $21 billion by 1993.

Summary Report:

Economy-Wide Impacts of the Farm Financial Crisis

1. Introduction

Evidence of a serious financial crisis in U.S. agriculture continues to accumulate. Early warnings of this debt/financial crisis have been loan delinquency rate increases, selected rural bank failures, and deteriorating farm balance sheets as indicated by state level surveys. Government data, the Federal Reserve Reports, and the ERS/USDA surveys have confirmed that the farm financial situation is deteriorating. These data and reports, however, were not produced with sufficient lead time to allow effective monitoring of the rapidly deepening farm credit crisis of late 1984 and 1985.

To close the information gap and to assess the extent and magnitude of the farm credit crisis in time for appropriate corrective action, Food and Agricultural Policy Research Institute (FAPRI) joined the *Farm Journal* magazine in conducting a national survey in December of 1984. The survey was designed to identify the incidence and extent of the farm credit problem at national and regional levels, by farm type and by tenure. With this survey information and farm price and income projections from FAPRI, it was possible to anticipate, under various Farm Bill options, the implications of the farm debt crisis. The magnitude and scope of corrective actions required to deal with the crisis were suggested as well.

The *Farm Journal* survey confirmed that the farm financial problem was not confined to a few states that had conducted early surveys. In December 1984 the Central and Western regions were worse off than the South and East, but the national average debt conditions were very similar to results of the state surveys conducted one year earlier and confirmed estimates made by the Federal Reserve. Of the $211 billion total farm debt, up to $140 billion is held by farmers experiencing financial stress.

The FAPRI analyses of 1985 Farm Bill options revealed a weak farm income outlook for 1985-1990 under the level of income protection provided by current programs. Very low levels of expected net farm income would result if government supports were to be removed. As net farm income declines, the ability of farmers to service outstanding debt is reduced, leading to more liquidation of land and other assets, and lower land values. These conditions increase the number of farmers who become insolvent and the magnitude of loan losses to lenders.

Concern about the potential impact on financial markets of large loan losses led to the Wharton Econometrics Forecasting Associates analysis, which investigated the macroeconomic consequences of the farm financial situation. The Wharton analysis shows that there are potentially serious consequences of the farm debt crisis on the U.S. economy. These impacts are higher interest rates, higher unemployment, reduced gross national product, fewer housing starts, lower personal income and a larger federal deficit. The Wharton analysis indicates that if preemptive actions are not taken, the loan losses could significantly effect U.S. financial markets. Such outcomes would seriously jeopardize the farm sector and impose important costs for those not directly employed by or involved in agriculture.

The potential negative economy-wide effects of a farm financial crisis and in addition to these the direct adverse impacts on agriculture, call for comprehensive measures to address the problem. Clearly, if farm sector financial failures should rise sharply, actions by the Federal Reserve, the U.S. Treasury, and the U.S. Congress will be required to stabilize farm asset markets and maintain order in the national financial markets. The analyses described below and in the supporting studies have been developed to give U.S. agriculture and those who determine farm policy, financial market policy, and Federal fiscal policy an opportunity to design corrective actions for the farm financial crisis that are efficient and timely. Early corrective and preventive measures will be less costly than absorbing the impacts of doing nothing or approaching the problem in a reactionary mode. The stakes for agriculture and national economic performance are high.

2. The Approach

A straightforward approach was adopted in projecting economy-wide impacts of the farm financial crisis. This approach is best illustrated by the set of questions that guided the research at FAPRI and Wharton.

- What is the debt situation for U.S. agriculture in total and by region, type of farm, and type of farm operator?
- What are the prospects of generating farm income sufficient to service this debt?
- What is the projected level of unserviced and discharged debt, and how is it distributed over time?
- What are the economy-wide implications if no action is taken to counter the impacts of the farm debt losses?

These relatively simple questions were evaluated using the Farm Journal survey, the FAPRI agricultural sector modeling system, FAPRI financial models, and the Wharton long-term model of the U.S. economy.

Results of the research organized by FAPRI to answer these questions are summarized in four reports (listed below) released on July 31, 1985, at a briefing led by Professor Lawrence Klein, Nobel Laureate and Professor of Economics at the University of Pennsylvania. This summary report reviews the analyses presented in the four reports.

Report #1 - "National Farm Survey on Financial Stress," Farm Journal and FAPRI at the University of Missouri-Columbia and Iowa State University, July 1985.

Report #2 - "An Analysis of the Variable Loan Repayment Option for the 1985 Farm Bill," FAPRI at the University of Missouri and Iowa State University, July 1985.

Report #3 - "Farm Income and the Financial Condition of United States Agriculture," FAPRI at Iowa State University, July 1985.

Report #4 - "Economy-Wide Impacts of Agricultural Sector Loan Losses," Wharton Econometrics Forecasting Associates, July 1985.

3. Debt Situation for U.S. Agriculture

Information on this question is drawn from the Farm Journal and supporting surveys now available for states and the United States as a whole. The analysis of this information is presented mainly in Report #1 with additional results provided in Report #3. In the Farm Journal survey, 8,000 owner-operators were randomly selected from a Farm Journal panel containing 1.1 million names. About 1,600 responses were received to a four page mail questionnaire. Of the questionnaires returned, 1,232 were useable for the analysis contained in Reports #1 and #3. Comparing this survey to national probability sample surveys from ERS/USDA indicates that both smaller- and larger-than-average farms were overrepresented, but this limitation of the data was more than offset by its timeliness. Preliminary results were published two months after completion of the survey (Farm Journal, March 1985).

Major results from the analysis of the Farm Journal survey are summarized in Tables 1 and 2. Table 1 contains information on the distribution of U.S. agricultural debt by debt-to-asset ratio. The debt-to-asset ratio measures relative indebtedness and is a simple indicator of financial stress. Generally, farmers with debt-to-asset ratios less than 40 percent are not experiencing severe financial stress. As shown in Table 1:

- The majority of farms are in the low debt-to-asset ratio category. About 69 percent of farms have debt-to-asset ratios of 40 or less and hold only 37 percent of the farm debt.
- Farms in the 40 percent and over debt-to-asset ratio categories composed about 31 percent of the total and held about 63 percent of the farm debt.
- About 27 percent of farm debt is held by the 14 percent of farm operators with debt-to-asset ratios of over 70 percent. Farmers in this category will have a difficult time correcting their financial problems.

In short, much of the outstanding agricultural debt is held by a minority of United States farmers, who are highly leveraged.

Table 2 contains information from the Farm Journal survey on average debt-to-asset ratios by age group and region. As shown in Table 2:

- The national debt to asset ratio is about 26 percent.
- Debt asset ratios are highest in the Central region and lowest in the East.
- Younger farmers have relatively high debt-to-asset ratios. The debt-to-asset ratio of farmers 44 years of age or younger is 10 percentage points above the national average.

4. Net Farm Income Prospects

The FAPRI agricultural sector models have been used during 1985 to evaluate projected outcomes for U.S. agriculture under various options for the 1985 Farm Bill. Two of the options evaluated are the free-market program advanced by the Administration (AAA85) and a variable loan repayment program (VLRP) that contains some of the elements in current proposals put forth by Senate and House members. The Administration program evaluated in March 1985 features loan rates and target prices that adjust to market price levels, and base acreage levels that adjust to actual planted acres. The essential result of the Administration program is that by 1991 the three-year moving average loan rate is the only potential buffer for farm prices and income.

The VLRP is a stylized option for the 1985 Farm Bill. It reflects a concern voiced in many existing proposals that the move to a free market agriculture requires a transition program to cushion the impact. This program, as applied in the FAPRI analyses, involves a four-year freeze of loan and target prices and of base acreages through the 1989/90 crop year. Diversion and deficiency payments are used to manage supply. The name given the VLRP was coined from a feature of the program that permits participating farmers to pay back the loan at the market price or the loan rate, whichever is lower. With the VLRP the loan rate does not set a de facto floor on market prices. This aspect of the program along with the loan and target prices assures more stable farm incomes but more competitive price levels for U.S. agricultural commodities. Commodity price paths under the VLRP are higher but approximate those under the AAA85 option.

Results of the comparative evaluation of the AAA85 and VLRP options are shown through 1990 in Table 3. For the analysis, general economic conditions in the U.S. and foreign economies were assumed to be similar to those during 1984-85. Evaluation of the VLRP in July 1985 incorporates more recent information reflecting higher commodity stocks and lower exports. Details on these assumptions, the features of the programs and the outcomes for major crop and livestock commodities are provided in Report #2 and a comparison study noted in Table 3. The results of the farm program analysis are:

- **Annual net farm incomes remain in the 21 to 27 billion dollar range under the VLRP, near the levels for 1985 obtained under the 1981 program.**
- **Annual net farm incomes fall to about 14 billion in 1988 under the AAA85 proposal and do not recover to the 20 billion dollar level within the 5-year period of analysis.**
- **Direct government payments average near 1985 levels under the VLRP and decline in later years, and no payments occur under the AAA85 after 1988.**

In general, the FAPRI farm policy analyses do not paint a bright picture for U.S. agriculture. These findings reflect a substantial excess capacity situation in

U.S. agriculture at current loan rates, indicating that high government costs are required to maintain net farm incomes near 1985 levels.

5. Projected Debt Discharge and Loan Loss

Estimates of the level of asset and debt liquidation required to achieve short term financial stability are presented in Report #3. The stability criterion chosen was that the farm businesses be able to service outstanding debt. An allowance for capital replacement or risk reserve was not included. In addition, this analysis estimated the likely volume of loan losses as well as the principal and interest shortfalls that would occur under a range of economic conditions.

Major results from the projected financial analysis for U.S. farm firms are provided in Tables 4 and 5. Table 4 presents estimates of the volume of assets and debt that would have to be liquidated for the remaining debt to be serviced fully. The cash rate of return expresses net cash income as a percentage of the value of gross assets owned by the operator. The recovery rate of capital measures the cash proceeds available for debt reduction following liquidation of an asset. The recovery rate reflects both transaction costs and declines in asset market prices. Estimates of operators selling out were obtained by assuming that operators go out of business when they have a zero or negative equity position after all of their assets were liquidated to retire existing debt. Debt charged off reflects debt remaining after liquidating all assets of these farmers. These charge-offs are losses that must be absorbed by agricultural lenders and other creditors.

Interest and principal shortfalls were estimated at current debt and asset levels (Table 4). The "lower income" case is suggested by the net farm income stream projected by FAPRI for the AAA85 option. The "current income" case corresponds to income streams like that projected for the VLRP option. The "improved income" case reflects a net farm income in the 30-35 billion range, exceeding that expected under any likely 1985 Farm Bill option.

From Tables 4 and 5, the major conclusions are:

- Approximately one-half of the outstanding farm debt cannot be fully serviced at current income and rates of interest. This figure increases to two-thirds in the lower income case.
- Annual principal and interest shortfalls from farm owner-operators are estimated at $2 to $9 billion over the four year evaluation depending on farm income levels and interest rates.
- Seven to seventeen percent of commercial agricultural assets in the United States will need to be liquidated in order to service the remaining outstanding debt; a liquidation rate three to four times the volume historically flowing through farm asset markets.
- For the more likely economic conditions evaluated, approximately 4 to 8 percent of the existing farm debt could be discharged by liquidated farm operations, respresenting a loss of $10 to $20 billion to all agricultural creditors.

Even under current farm income conditions, loan losses could be significant. If farm income falls, as projected under the AAA85, farm financial conditions deteriorate and loan losses increase substantially. This serious potential loss to the financial and agribusiness sectors stimulated interest in the Wharton study of macroeconomic impacts of the financial crisis in U.S. agriculture.

6. Economy-Wide Impacts

The macroeconomic effects of the agricultural loan default were estimated using Wharton's Long-Term Model of the U.S. economy. The Federal Reserve Board, the Administration, and the U.S. Congress are assumed to intervene as the loan defaults occur to insure the stability of the U.S. financial system. This intervention would be reactive rather than preemptive; actions would respond to loan defaults and actual or imminent failures of the affected financial institutions. Preemptive actions, on the other hand, could reduce or eliminate the estimated negative macroeconomic repercussions of the agricultural sector loan default.

The main direct macroeconomic effect of the agricultural sector loan defaults would be an increase in short-term private interest rates due to the public perception of substantially higher risks being associated with financial asset holdings. This perception of increased risk would occur despite prompt action by the financial authorities, such as was the case for the Continental Illinois National Bank. Despite FDIC guarantees for all deposits, outflows became unduly large because of the inherent unease (perceived risk increase) associated with keeping deposits in a potentially failing bank. Although agricultural debt is dispersed among many creditors, the impact of large and widespread defaults on commercial banks and the Farm Credit System is expected to be sufficient to affect national financial markets.

The farm loan defaults have two direct impacts on the U.S. economy:

- Higher short-term interest rates due to the increased public perception of financial asset risk.
- Higher interest rate risk premiums in the agricultural credit market, reflecting the high rate of agricultural sector loan default.

The evaluations of impacts of the farm financial crisis were conducted under the four scenarios defined in Table 6. The VLRP and AAA85 programs together with the analysis in Report #3 yielded differing assumptions on the total loan loss. The extreme case on the high-loss side assumes no income maintenance programs and no financial assistance programs. The scenario with the lowest loan loss is a case where income maintenance programs continue at current levels and preemptive financial assistance programs are in place.

The total losses were distributed across the years 1985-88 using the FAPRI net farm income estimates. Potential loan losses are higher under the "free market" option, due to the lower farm income available to service debt. Short-term interest rates are expected to respond strongly to the large loan losses in 1987. Specifically, from Figures 1 and 2:

- The public loses confidence in the private financial sector due to loan defaults, leading to a run-up in private short-term interest rates, peaking in 1987 when the loan default rate is highest.
- Longer-term commercial bond rates rise by more moderate amounts than the private short-term rates but remain above baseline levels for a longer period of time.

The major economy-wide impacts are caused by these short term interest rate movements -- 75 to 125 basis points for loan losses in the "middle range" of $20 to $25 billion compared with 25 basis points when loan losses are reduced to $10 billion.

Results of the Wharton evaluation for the middle range of loan losses ($20 to $25 billion), relative to the baseline outlook, are illustrated by Figures 3, 4, and 5, for the federal debt, employment, and gross national product, respectively.

The major conclusions of the Wharton analysis are:

- By 1993, the federal debt will be $13.7 to $21.5 billion larger.
- In 1989 between 175,000 and 275,000 jobs will be lost in the entire economy.
- In constant 1985 dollars, Gross National Product will be reduced by $8.6 to $13.7 billion in 1989. The cumulative losses in real GNP over the 1985-93 period are predicted to be $30 to $49 billion.

These impacts are compared in Table 7 with those generated by higher and lower loan loss assumptions. The comparisons suggest a trade-off between the costs of income maintenance and financial assistance programs and the consequences for the economy of ignoring one or both of these preemptive measures. It would be prudent to consider early, comprehensive measures to correct the farm financial crisis rather than to attack it on a piecemeal or crisis-reaction basis. Clearly, loan losses will not occur at the high end of those evaluated, because countervailing actions will be taken. The question is whether these actions can be less costly if they are managed and coordinated through legislation and administrative initiatives not developed on a reactionary basis.

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Table 1. National Agriculture Debt Distribution Estimated From *Farm Journal* Survey.

Debt/Asset (Percent)	% of Farms	% of National Debt	% of Agricultural Assets
00-10	39.5	2.9	36.8
10-40	29.4	34.2	37.1
40-70	17.5	36.3	18.5
70 Plus	13.6	26.6	7.7
Actual Levels	1.67 mil.	$210.8 bil.	$951.7 bil.

Source: A. Womack, et. al., "National Farm Survey on Financial Stress," FAPRI Staff Report #6-85, July 1985.

Table 2. Agricultural Debt to Asset Ratios by Region and Age Group Estimated from *Farm Journal* Study.

	Age					All Age
	Under 35	35-44	45-54	55-64	Over 65	Groups
Region	D/A	D/A	D/A	D/A	D/A	D/A
Central	52.1	45.4	38.0	22.5	11.0	34.3
West	31.2	29.6	22.1	25.8	16.7	25.2
South	20.8	37.1	20.8	21.0	4.0	19.7
East	51.4	26.4	21.3	10.7	8.5	20.3
Weighted National Average	35.9	37.3	26.9	22.4	7.4	26.1

Source: R.W. Jolly and D.G. Doye, "Farm Income and the Financial Condition of United States Agriculture," FAPRI Staff Report #8-85, Iowa State University, July 1985.

Table 3. Farm Income and Government Payments Under the Administration (AAA85) and Variable Loan Repayment (VLRP) Programs.

	Date	Program	1983*	1984*	1985	1986	1987	1988	1989	1990
						($ billion)				
Direct Government Payments	July 1985	VLRP	9.30	8.00	5.90	6.20	6.30	5.90	5.80	6.00
	Mar. 1985	AAA85	9.30	8.00	5.12	4.75	3.26	0.47	0	0
Net Farm Income	July 1985	VLRP	16.40	35.30	23.70	24.70	27.40	26.10	23.80	21.60
	Mar. 1985	AAA85	16.40	35.30	24.63	21.13	16.50	13.50	15.78	16.25

Sources: VLRP- "An Analysis of the Variable Loan Repayment Option for the 1985 Farm Bill," FAPRI Staff Report #7-85, University of Missouri, Columbia and Iowa State University, July 1985.

AAA85- "The Administration Proposal for the 1985 Farm Bill: An Evaluation and Analysis," FAPRI Staff Report #3-85, University of Missouri-Columbia and Iowa State University, March 1985.

*Actual USDA figures.

Table 4. Annual Interest and Principal Payment Shortfalls with Current Debt and Asset Levels, United States.

	Current Income [1]	Lower Income [2]	Improved Income [3]
Interest ($ billion)	1.12	3.22	0.26
Principal ($ billion)	3.68	5.64	1.89
Total ($ billion)	4.80	8.86	2.15
% debt not fully serviced	52.9	65.3	29.5
% debt with interest not fully paid	21.7	44.5	7.8

[1] Cash returns of 7.5 percent on capital, mean interest rate of 10 percent.
[2] Cash returns of 6.5 percent, interest rate of 12 percent.
[3] Cash returns of 8.5 percent, interest of 8 percent.

Table 5. Estimated Asset Liquidation Required to Service Remaining Debt, United States.

	Current Income 1/	Lower Income 2/	Improved Income 3/
	%	%	%
Assets liquidated	9.9	16.8	6.6
Debt liquidated	34.0	48.0	25.6
Debt charged-off	3.9	8.5	2.1
Operators selling out	8.1	14.6	5.2

1/ Cash returns of 7.5 percent on capital, capital recovery rate of 85 percent.
2/ Cash returns of 6.5 percent, capital recovery rate of 65 percent.
3/ Cash returns of 8.5 percent, capital recovery rate of 100 percent.

Table 6.- Financial Impacts of Agricultural Sector Loan Losses Under Four Scenarios.

Program, Loan Loss and Interest Rate Effects	Year 1985	 1986	 1987	 1988
Hard Landing (Free Market Income Levels)				
Large Loss ($50 billion, No Financial Assist)				
Loss Pattern (Billions $)	2	10	33	5
Short-Term Rate Increase (Basis Points)*	10	60	275	125
Medium Loss ($25 billion, With Financial Assist)				
Loss Pattern (Billions $)	2	4	16.5	2.5
Short-Term Rate Increase (Basis Points)*	10	25	125	75
Soft Landing (Current Income Levels)				
Medium Loss ($20 billion, No Financial Assist)				
Loss Pattern (Billions $)	2	4	12	2
Short-Term Rate Increase (Basis Points)*	10	20	75	40
Small Loss ($10 billion, With Financial Assist)				
Loss Pattern (Billion $)	2	2	5	1
Short-Term Rate Increase (Basis Points)*	10	10	25	10

*This is the increase for the private short-term (6 month commercial paper) rate. Government sector interest rates were unchanged between the default scenarios and the baselines.

Table 7. Key Macroeconomic Impacts of Agricultural Sector Loan Losses.

	Loan Loss Scenario			
	Free Market Income		Current Income	
	No Assist	Assist	No Assist	Assist
Economic Variable	$50 billion	$25 billion	$20 billion	$10 billion
Federal Debt Increase (Billion $, 1993)	$42.2	$21.5	$13.7	$5.1
Real GNP Decrease (Billion 1985$, 1985-93)	-$96.7	-$49.0	-$30.9	-$12.2
Employment Decrease (Thousands, 1989)	-560.	-275.	-175.	-64.

Figure 1
Middle Range of Short Term Interest Rate Impacts

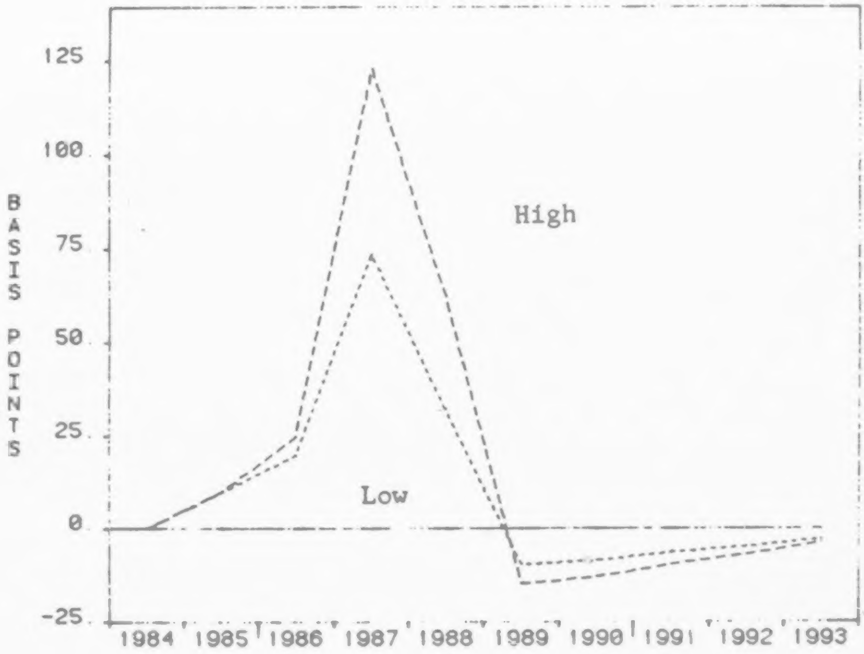


Figure 2

Middle Range of Long Term Interest Rate Impacts

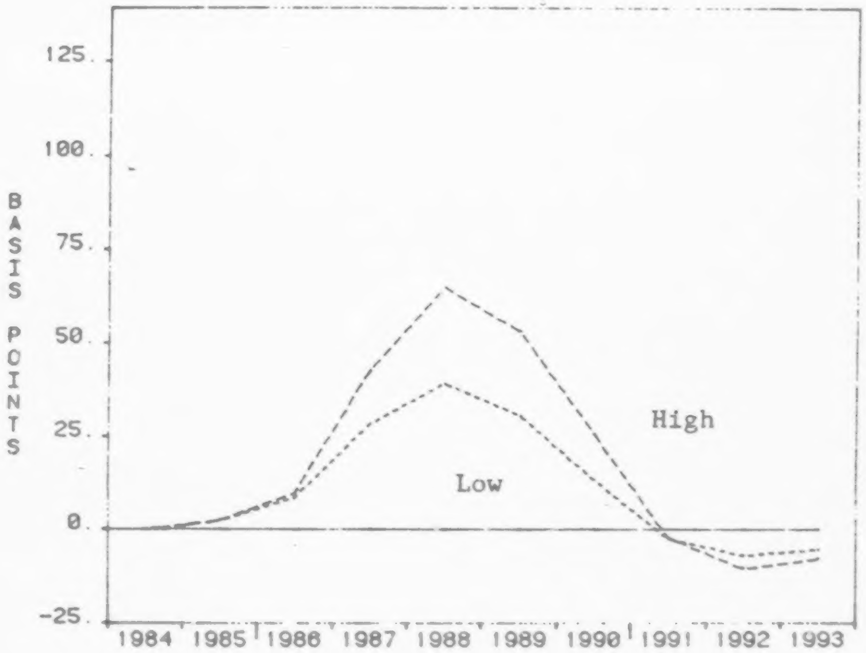


Figure 3

Middle Range of Cumulated Federal Debt Impacts

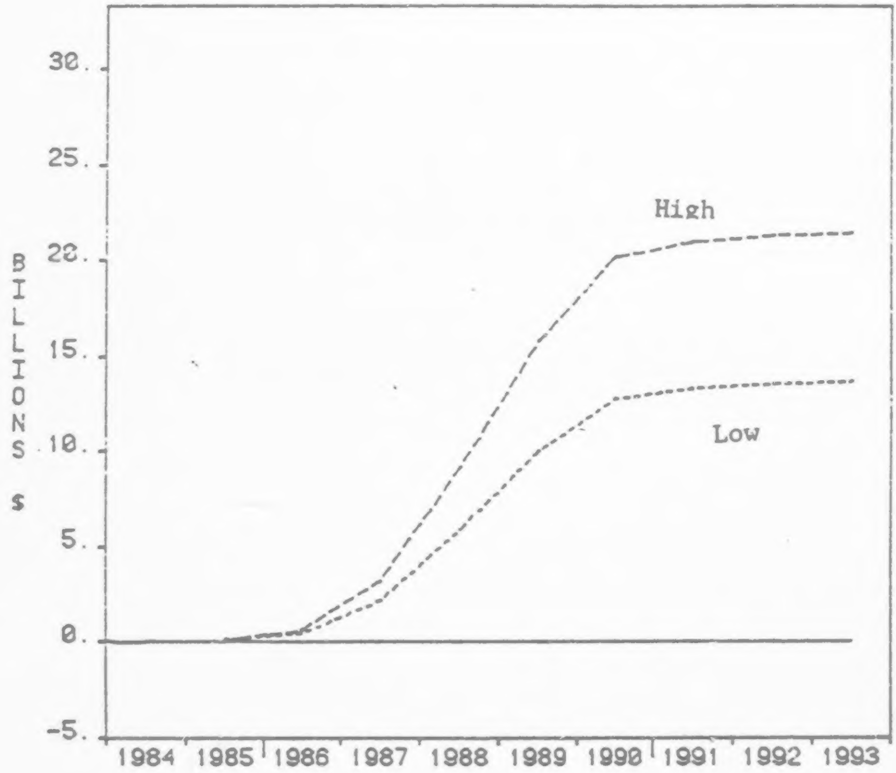


Figure 4

Middle Range of U.S. Employment Impacts

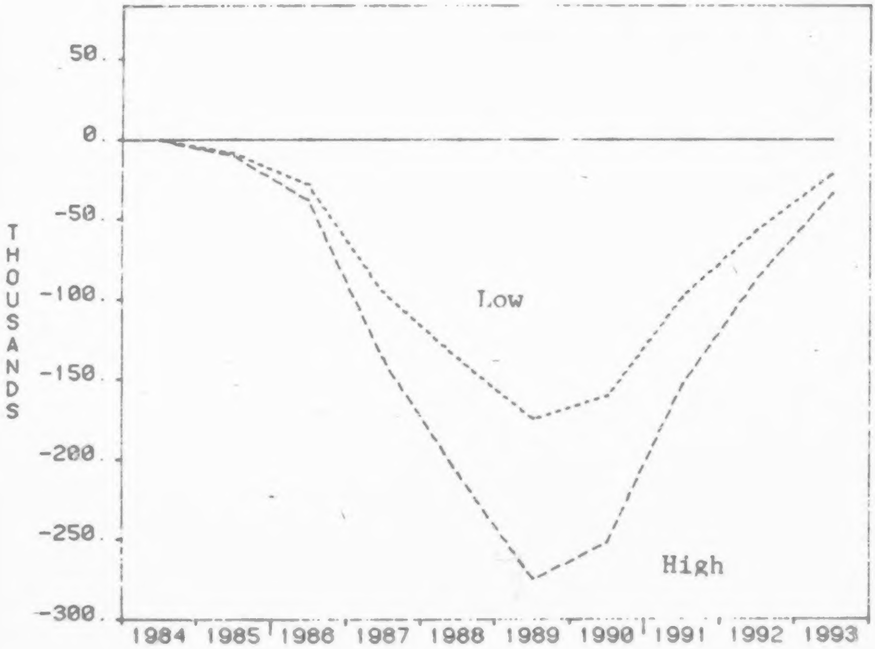
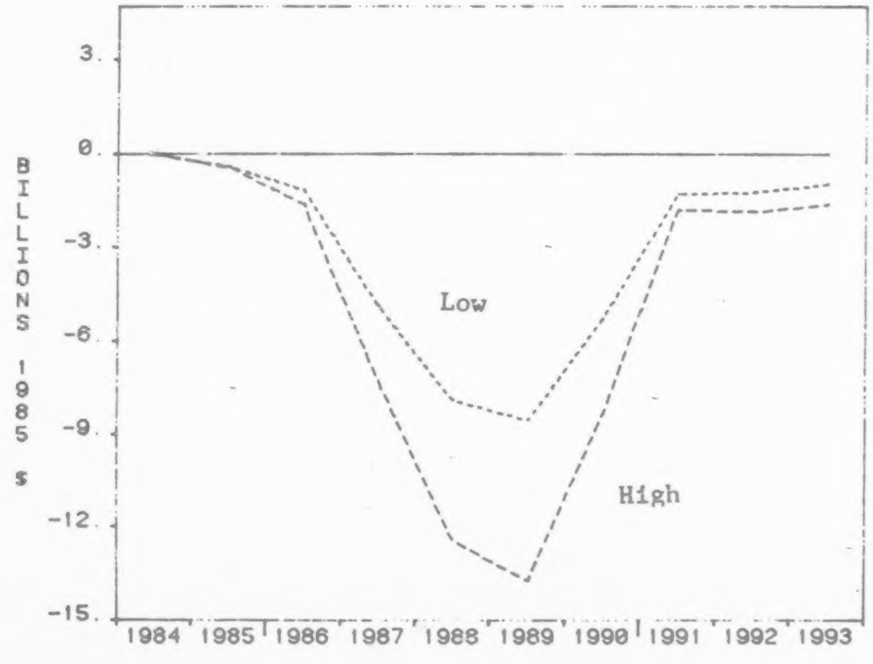


Figure 5

Middle Range of Real GNP Impacts



TESTIMONY OF ROGER B. SLEDD

Mr. Chairman, and members of the subcommitte, I am here on behalf of directors and stockholders of the Fourth District Associations concerned about misrepresentations, coercion, and intimidation that has been exerted on the directors of the associations of the Fourth District to compel them to vote for the consolidation of associations into one joint managed land bank and one production credit association in Louisville, Kentucky.

At a recent meeting in Paducah, Kentucky, 55 directors favored the 28 joint-association plan, 4 favored the 1 PCA and 1 FLBA association plan, and 4 did not vote for either plan.

I cite these numbers to show how compelling the opposition is to the one association plan among the directors of the associations.

It is not our intention to oppoose or minimize the need for help that exists in the Farm Credit System. Rather, Mr. Chairman, we are here to ask you and the members of this Committee to use your oversight authority and influence to require the Fourth District in Louisville, Kentucky, to withdraw the consolidation plan that has never been formally presented to the stockholders of the associations and either permit the stockholders to vote on the 28 association plan as originally proposed or amend the statutes to make clear that the associations can be consolidated and unified in the manner and form presently being attempted.

Under no circumstances should the plan be permitted to be submitted to the stockholders under the air of intimidation and misrepresentations that currently prevail. To permit this vote and the further dilution of control and input from the local borrower/stockholders will have major consequences on the efforts to stabilize and maintain the Farm Credit System, in our opinion.

The increase in interest rates in the Fourth District is a burden that the farmer/borrower cannot shoulder and has had the consequence to drive the good loans out of the system.

In January, 1985, there were 4.7 billion in loans outstanding in the Fourth District, on September 30, 1985 there were 4.2 billion in loans outstanding, a loss of 538 million in outstanding loans which in large measure was caused by the ill-advised interest rate increase. The impact of this pay down in loans can only be estimated. It is clear that only credit-worthy loans attractive to other institutions have been lost at lower rates. Not only did the system lose the good loans but accruing interest at 13.25 percent or an effective 14.00 per cent rate when the farmer is operating in an agricultural economy that does not even return production costs is engaging in self-deception and mismanagement in its highest form. Put simply, the Fourth District may accrue interest at 14.00 percent but the borrower/stockholder cannot pay it.

As you well know, Mr. Chairman, the farmer today is in a critical situation brought on by a strong dollar that has encouraged inports of cheaper farm products, and discouraged the export of American farm products. A period of deflation, after rapid inflation which encouraged borrowing and expansion by well-intentioned farmers attempting to protect themselves from the inflation, and a policy of free markets with an overcapacity of production that seems to be limited only by the American farmer's imagination and capacity for output. Specifically, whether we agree or disagree with the present agricultural policies or those that preceded them, the American farmer today is dealing with a situation that good management and better production efforts cannot solve, at least in the short term.

In the last eight months, I have seen the over production of grapes in the Napa Valley, the devastation of the citrus crop in Central Florida from two years of successive freezes, the great depression in the grain belt and the loss of real income in the tobacco producing states. Sir, the present agricultural crisis is not confined to any geographical area and represents the most compelling and critical need in our country today. The fallout from the absolute collapse of the agricultural sector of the economy, which includes the Farm Credit System, will have devastating consequences on land values, tax bases of state and local governments, and the collapse of our financial institutions, not to mention the human suffering and costs.

There are no easy solutions, the alternatives at best are not without serious consequences, but the delay will only make more expensive the remedies and input that must ultimately be provided.

FIRST: Local control of the Farm Credit System must be maintained and strengthened by requiring the continuance of the election of the local boards by the borrower/stockholders.

SECOND: A change in the method of electing the District Bank Boards to reflect the true representation of the Board by those who own it and not those who use it. Specifically, the borrower/stockholders should elect the boards of directors of the District Banks in proportion to their contribution of assets to the District Bank on an annual basis.

The hard-headed conservative control of those who own the system will tighten the controls and require the system management to provide a workout and management of existing loans on the local level.

The erection of expensive buildings on the District Bank level filled with overpaid managers mumbling about the plan of 1995, has no place today. The large corporations have no interest in operating businesses that cannot get a profit to the bottom line.

THIRD: Define a clear line of demarcation between the management and regulation of the system on the national level. The model of the F.D.I.C. would be a start in terms of separating the functions of the Farm Credit Administration and insuring that the regulator is not also the manager of the system. This has caused excesses and abuses which have loosened the control needed to insure the continuance of the system. There is need for strong national regulation of the system, but in our opinion we have asked too much of the present FCA and we need to define and limit the control of the FCA management function, and look to the local borrower/stockholders boards on the local and district level for authority and responsibility.

FOURTH: The focus of this Committee should be to help the Farm Credit System, the needs of commercial banks, insurance companies and other lenders are a part of the total package, however, the Farm Credit System can be helped by specifically looking to the 1933 Emergency Farm Mortgage Act. The advantage of that act is, (1) it has precedence; (2) it worked; and (3) it is comprehensive in its approach.

Specifically, buy down interest rates; defer principal payments; write down a portion of the debt in exchange for a promise to make future payments.

The cost of this proposal cannot be estimated without more and better numbers from the FCA, however, there is one thing I am absolutely sure of, the failure to act forthrightly, courageously, and soon, will only increase the cost of saving the major component of agricultural lending, a system that ultimately cannot be permitted to fail without the most serious of consequences to all Americans, not just the farmers.

Thank you for your time and consideration.

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October 31, 1985

Honorable Ed Jones, Chairman
Subcommittee on Conservation and Credit
Committee on Agriculture
House of Representatives
108 Cannon House Office Building
Washington, D.C. 20515

Dear Congressman Jones:

The Farm Credit Act, as amended, ("the Act") allows the Farm Credit Administration ("Administration") to adopt regulations authorizing the banks and credit associations that belong to the Farm Credit System to sell:

> "...on an optional basis,...credit or term life and credit disability insurance appropriate to protect the loan commitment...and other insurance necessary to protect the member's farm or acquatic unit, but limited to, hail and multiple-peril crop insurance, title insurance, and insurance to protect the facilities and equipment...." 12 U.S.C. 2218(a).

If the Administration adopts regulations authorizing the sale of insurance, as it has, then it must also adopt regulations requiring that: (1) borrowers be given notice that they may obtain their insurance elsewhere, if insurance is a condition of a loan; (2) the bank or association has the capacity to offer insurance services "in an effective and efficient manner"; (3) it is probable that any insurance program "will generate sufficient revenue to cover all costs"; (4) the insurance service "will not have an adverse effect on...credit or other operations...; and (5) no bank or association discriminates against any unaffiliated agent or insurer or any party who buys insurance from such unaffiliated person, 12 U.S.C. 2218(b). The Administration has adopted regulations which include all of these conditions. 12 CFR 618.8030 (September 3, 1982).

On behalf of the National Association of Crop Insurance Agents, a non-profit organization of independent insurance agents, we urge that Congress ensure these regulations are enforced or that System members are barred from the sale of insurance.

The sale of insurance by System banks and associations began in 1971 when that year's amendments to the Farm Credit Act first allowed System institutions to provide financially related services to their borrowers. By 1980, however, "various controversies" had arisen "over the proper scope and range of insurance services..." and Congress enacted Section 2218, described above, "to clarify controversies by specifically enumerating the types of insurance System institutions may offer to their members on an optional basis." (H. Rept. 96-1287, p. 23).

In addition, to emphasize its intent that borrowers and insurers be protected from a recurrence of controversy, the Congressional committees responsible for consideration of the 1980 amendments described a policing system it expected the Administration to establish and maintain. The policing system was explained by the House Committee on Agriculture:

> "The Committee expects the banks to approve at least two insurers and two programs in each district so as to provide the associations a choice in such matters. The associations would be free to choose from among two or more approved insurers and insurance programs. The banks may, only by agreement with an insurer, offer services traditionally furnished by insurers to the Farm Credit System. Further, the banks are not to underwrite insurance applications, adjust claim payments or settlements, or train and school or service adjustors or insurance agents.
>
> "The banks are expected to supervise the manner in which the production credit associations offer insurance programs approved by the banks, without coercion or suasion from any bank in favor of any agent or insurer. However, the banks may provide to the production credit associations comparative information regarding cost and quality of the approved insurance programs and the financial condition of approved insurance companies. Bank supervision shall ensure that insurance services offered by approved insurers through production credit associations are consistent with the intent of the Act."

The regulations that Congress required the Farm Credit Administration to adopt, while no doubt wise in their time, are now of questionable efficacy and doubtful efficiency.

Facing losses that are reported to be staggering and seeking a workout in a collapsed farm economy, should System banks continue to devote resources to the examination and approval of insurance programs and insurance companies? In their current condition, can System banks ensure that offers of insurance by credit associations are "without coercion or suasion" and "consistent with the intent of the Act"? What are the priorities of System banks and how shall their resources be allocated?

By the same token, can the public afford the consequences of less supervision and a recurrence of the controversies Congress sought to avoid? What assurance can there be that desperate for cash flow and freed from their watchdogs, production credit associations will not make unwise loans or loans larger than warranted to earn commissions on the sale of insurance? Will production credit associations be tempted to overlook their notice to borrowers that insurance can be obtained elsewhere? And, in order to generate commissions to reduce overhead, might they require insurance where none should be needed or where less would be needed?

Apart from the foregoing, does the protection of loan commitments or farm units or farm equipment really necessitate the sale of insurance by lending banks? Indeed, how are loan commitments and farm units and farm equipment protected when the banks that sell the insurance protection may not (and should not) provide the services that give insurance its full value?

If the answers to these questions are not reasons to bar System institutions from the sale of insurance, they certainly are reasons to adopt new safeguards against controversy and conflicts. Developments in the sale of federal and multiple-peril crop insurance illustrate the need for these safeguards.

In 1980, Congress amended the Federal Crop Insurance Act and directed that the Federal Crop Insurance Corporation "...to the maximum extent possible...encourage the sale of Federal crop insurance through licensed private insurance agents...." Congress also directed the FCIC "to provide reinsurance to the maximum extent practicable." As a result, there has been an increased role by private agents and commercial companies in the sale of crop insurance. System members, however, often operate at cross purposes with the intent of the Federal Crop Insurance Act and with the intent of their own enabling law.

As noted above, the House Committee on Agriculture directed "...the banks to approve at least two insurers...." Instead, and at least with respect to crop insurance, System banks are approving only two insurers instead of "at least two insurers." As a result, banks have restrained the sale of crop insurance; they have excluded insurers from the very market place to which Congress wanted them invited; and, thereby, banks have fostered favoritism and artificial restraints on competition.

The FCIC has established financial and other conditions for its contractors. System banks should not be allowed to preempt the FCIC's expertise and bar insurers the FCIC has approved. We ask that any insurance company or agency under contract with the FCIC be deemed approved for purposes of the Farm Credit Act.

If 12 U.S.C. 2218 is not repealed, it must be enforced diligently. To avoid the conflicts and controversies that existed in the past and to prevent new ones from arising, Congress should ensure that the Administration more carefully regulates bank participation in insurance markets. Otherwise, the temptations during periods of financial stress may be overwhelming.

Sincerely,

Larry Rosenstein

Larry M. Rosenstein

FARM CREDIT ACT AMENDMENTS OF 1985

THURSDAY, NOVEMBER 21, 1985

House of Representatives,
Subcommittee on Conservation,
Credit, and Rural Development,
Committee on Agriculture,
Washington, DC.

The subcommittee met, pursuant to call, at 10:15 a.m., in room 1302, Longworth House Office Building, Hon. Ed Jones of Tennessee (chairman of the subcommittee) presiding.

Present: Representatives Weaver, Glickman, Stenholm, Tallon, Evans of Illinois, Thomas, Coleman, Jeffords, Morrison, Gunderson, Evans of Iowa, and Franklin.

Also present: Representative E (Kika) de la Garza, chairman of the committee; Representatives Volkmer, Olin, Penny, Madigan, Marlenee, Stangeland, Combest, and Schuette, members of the committee.

Staff present: Phillip L. Fraas, counsel; Robert T. Lowerre, associate counsel; Cristobal P. Aldrete, special counsel; Charles Hilty, minority staff director; William E. O'Conner, Jr., assistant minority staff director; John E. Hogan, minority counsel; Mark Dungan, minority associate counsel; Glenda L. Temple, clerk; Bernard Brenner, Robert A. Cashdollar, James W. Johnson, Jr., and Susan Adkins.

OPENING STATEMENT OF HON. ED JONES, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE

Mr. Jones of Tennessee. Good morning, ladies and gentlemen. The Subcommittee on Conservation, Credit, and Rural Development will come to order.

I have a very short statement to make before we hear the witnesses. Before then, I will defer to members of the subcommittee for any statement they might like to make.

I appreciate your attendance at this very important hearing of the subcommittee on the subject of farm credit. We are going today to be talking about H.R. 3792, the Farm Credit Act Amendments of 1985. Today's hearing is the fifth in a series of hearings this subcommittee has held over the past several weeks to review agricultural credit conditions, the problems, and proposed solutions that we face.

As a result of testimony received in previous hearings regarding the need to address specific and critical problems in the Farm Credit Cystem, Chairman de la Garza, Mr. Madigan, Mr. Coleman, and I joined together yesterday to introduce H.R. 3792. Today's hearings will focus on this legislation with the idea in mind that we hear from the three principal parties involved and affected under the bill.

Representatives of the administration from the Departments of Treasury and Agriculture, the Governor, and senior Deputy Governor of the Farm Credit Administration, and representatives of the Farm Credit System will sit together at the witness table this morning. Each witness will be recognized for 5 minutes for any remarks he may wish to make about the pending legislation before us or the issue generally. Hopefully, we can then set into more details about the bill and with witnesses' position on its provisions during questioning by members of the subcommittee.

We will also operate under a 5-minute limit during questioning with opportunities for followup rounds if members wish. Copies of the bill and a summary of its major provisions were delivered to members yesterday afternoon. I apologize for any inconvenience this may have caused members, that you have so little time to review the bill. But I do hope that today's hearing will clarify and answer many of your questions.

[H.R. 3792 and the reports from the U.S. Department of the Treasury and the Farm Credit Administration appear at the conclusion of the hearing.]

Mr. Jones of Tennessee. I now recognize Mr. Coleman, the ranking minority member of the subcommittee, for any remarks that he may wish to make.

OPENING STATEMENT OF HON. E. THOMAS COLEMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MISSOURI

Mr. Coleman. Mr. Chairman, thank you very much. I will be very brief.

The fact that you have led our subcommittee in these efforts, I think, is very fine on your behalf. I am glad to join with you in the support and sponsorship of H.R. 3792. Obviously, we are dealing with a very complicated and complex subject. But basically we have tried to do three things in this legislation. One is to restructure the Farm Credit Administration to give it greater regulatory power over the Farm Credit System, to create a new system for marshaling funds and warehousing bad loans to be able to transfer funds from one institution to another within the Farm Credit System as a cooperative by definition would be compelled to do. Also, we recognize that to rebuild investor confidence in the Farm Credit System is probably the whole basis of our actions. Therefore, we do propose a line of credit at the discretion of the Secretary of the Treasury for this assistance to the Capital Corporation.

The reason for the Farm Credit System in the first place, we should all remember, is to help farmers have a steady and competitive line of credit. It is critical to calm the fears on Wall Street and the people who purchase these securities to let them know that, in fact, something is being done and, in fact, something is being done correctly. To calm these fears, in order to raise sufficient funds to loan to farmers and keep borrowing costs to farmers reasonable is something we should all be concerned about.

I think time is of the essence. I think this particular bill will have to be passed by the end of the year, as billions of dollars of these securities are rolled over every month on Wall Street. If the investors are concerned about their security, and the premiums on these, and interest rates have to be increased, it simply ends up going back to our farmers, who borrow at higher interest rates themselves from the system.

The line of credit is an issue which we will look at today. But it seems to me that the best type of rebuilding of investor confidence would come with this line of credit. It would act as a life preserver to investors who see their boat indeed taking on more water at the present time but that land is approaching. With that type of confidence, I think we can reverse the psychology of Wall Street and keep interest rates down for our constituents, America's farmers.

Mr. Chairman, thank you very much.

Mr. Jones of Tennessee. Thank you very much, Mr. Coleman.

May I say, before I recognize the other members of the subcommittee, that much diligent effort has been put forth by this subcommittee and by staff that has been involved in the writing of H.R. 3792. I do appreciate more than anyone knows, the effort, the long hours, and the diligence that has been made by everyone to put this bill together.

Now, Mr. Stenholm, for any remarks that you might have.

OPENING STATEMENT OF HON. CHARLES W. STENHOLM, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. Stenholm. Thank you, Mr. Chairman.

I, too, would commend you, Mr. Coleman, Mr. de la Garza, and Mr. Madigan for the work that you have done in putting together what I consider to be an excellent blueprint for solving the problem that we are faced with. I read the bill last night, thick as it is. I have several questions that I will want to ask. I may have an official statement for the record. I will not take the time today except to again repeat that I believe that the concerns that both you and Mr. Coleman mentioned, that we have a blueprint in this bill for solving it. I look forward to this hearing getting some of the questions answered that I have.

Mr. Jones of Tennessee. Without objection, if you or any other member of the subcommittee has a statement, it will also be inserted in the record.

[The prepared statement of Mr. Stallings follows:]

STATEMENT PRESENTED BY REPRESENTATIVE RICHARD H. STALLINGS BEFORE THE HOUSE SUBCOMMITTEE ON CONSERVATION, CREDIT, AND RURAL DEVELOPMENT , NOVEMBER 21. 1985.

Mr. Chairman, thank you for the opportunity to make a few remarks before the committee, and I want to also thank the panel of distinguished witnesses that have agreed to appear before this subcommittee today.

Every day as we work on farm legislation here in Congress, the farm crisis grows deeper in Rural America. The Second District of Idaho, which I represent, is a rural district and every farmer is saying the same--"WE NEED INCOME, NOT MORE CREDIT". However, as we see the critical situation that has engulfed the Farm Credit System, we realize that more credit is not the single solution, but a viable Farm Credit System to help keep our farmers on their land is absolutely essential.

The Spokane District of the Farm Credit System encompasses my congressional district in Idaho. This was one of the first Districts to ask for help from the System , in order to keep the Spokane FICB a viable lender of short-term operating capital. Much has happened in the reorganization and merger of the Spokane District and I will not dwell on that. But the fact is, the farmers and stockholders of the District are the ones who will ultimately benefit or lose from we accomplish here in Congress.

I would like to share some of the facts on what is happening in Idaho, and from what I read and hear from other states the facts are about the same across the country. In a survey commissioned by the Governor of Idaho earlier this year, nearly 35 percent of our farmers were in serious trouble. As the report further stated, Idaho may lose 10 percent of its 24,600 farmers in 1985. Foreclosures are becoming a common practice for lending institutions, and Chapter 11's are being filed at an alarming rate. Small business and communities are not immune. Local, county, and state governments are sacrificing needed public services because of the loss in tax revenue.

One of the things being done in Idaho in response to the rash of foreclosures and liquidations is the creation of a Farm Foreclosure Review Board. This board has the authority to mediate between the farmer and his creditor in any foreclosure action. However, the Board's recommendations are not binding on the lender or the farmer. With this type of effort, some of the serious problems being created by the credit crunch are being minimized.

I also recognize that failure of the Farm Credit System, the farmer-owned cooperative which holds one-third of the farm debt, would be devastating to the entire economy. This would send serious shockwaves through our nation's entire financial structure and would ultimately result in much higher interest rates for all farmers.

I am very pleased that legislation has been proposed before this committee that addresses the resolution of some of the Farm Credit System problems. However, the fact still remains, that the FCS holds only one-third of the farm debt. This is a beginning, but as we design legislation to solve the Farm Credit System problems, we should also realize that help is needed for that other two-thirds of the farm debt. It is my sincere hope that we can develop legislation to help the entire credit structure of agriculture and design programs to increase income for America's Farmers.

Mr. JONES of Tennessee. Mr. Gunderson, you are recognized.

Mr. GUNDERSON. Mr. Chairman, in the interest of time, I am not going to make an opening statement today.

Mr. JONES of Tennessee. Mr. Lane Evans.

Mr. EVANS of Illinois. I have no opening statement, Mr. Chairman.

Mr. JONES of Tennessee. Mr. Cooper Evans.

Mr. EVANS of Iowa. I have no opening statement, Mr. Chairman.

Mr. JONES of Tennessee. Mr. Franklin.

Mr. FRANKLIN. No, thank you, I have no opening statement.

Mr. JONES of Tennessee. I am delighted that the chairman of the full committee is here this morning, as well as the ranking minority member of the full committee. I would like at this time to recognize Mr. de la Garza.

OPENING STATEMENT OF HON. E (KIKA) de la GARZA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

The CHAIRMAN. Thank you, Mr. Chairman. I appreciate the subcommittee's having this hearing. I don't want to take too much time away from our witnesses this morning.

I would like to say that the package that is being proposed has been a bipartisan effort throughout. A lot of work has gone in from every available source of input that we have been able to reach to: the Farm Credit System, Farm Credit Administration, the grassroot organizations, individual borrowers, investors, the Department of Agriculture, the Treasury, to the extent that they speak for the different councils which have met, the White House. So, I think that we have what we perceive as a finite consensus to the extent that it is possible for us to decipher the concerns of the different parties.

I have been asked repeatedly whether we will let the Farm Credit System falter, if it continues having difficulty? My perception is that the decision has already been made: No, we will not. Not the White House, not the Treasury, not the Department of Agriculture, not we in the Congress. We now continue with how we assist and what timeframe we do it in. But I think the decision has been made that we will assist if the assistance is needed, that we will reorganize to the extent that we see the need for reorganization.

I want to thank everyone who has contributed toward that effort. Timing, that is something that is yet to be decided, whether we do it in the first two sections, the next section, or whether we do it together in all three sections, reorganizing of the system, reorganizing of the administration, and the possibility of financial assistance, that question is yet to be decided. But I think that we can move expeditiously at least to send the message that we will not let the system fail, that it is not going to fail, and that we will do everything possible to make it a viable, workable system.

However, there are two big problems facing farmers that we have to deal with collaterally. First, you can do all you want to the system, if the income isn't there for the farmer, that is something that also must be addressed. Second, you can do everything you want to the system, and if the available source of funding to the farmer is at rates viable to the needs of the system, but so high that the farmer does not have adequate credit according to his economic situation, that also must be addressed. Those two problems are beyond the extent of our legislation. Yet, probably they are the two most important.

We have to send a message that we are going to do everything to see that eventually the resolution of those two problems falls into place. I hope that this is a good first step today.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. de la Garza.

Because of a conflict that Mr. Jeffords has, Mr. Madigan, if you don't object, I am going to recognize him at this point for any statement he might have.

OPENING STATEMENT OF HON. JAMES M. JEFFORDS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VERMONT

Mr. JEFFORDS. Thank you, Mr. Chairman. We often have two things to do at once. I've got four things all at the same time this morning. The bill first up or second up is mine on the House floor.

I just want to sort of echo the words of the chairman and say that obviously all of us are deeply concerned about the situation. We all have special concerns in our areas. I am sorry that I will not be able to be here, but I am sure that we will have permission from the chairman, if there are questions that are not asked, to be able to ask in writing questions to the witnesses this morning. I obviously will be following very carefully.

I do appreciate the efforts that have been made so far to accommodate some of the interest in the bill that was introduced. I deeply appreciate all of the work that the chairman and others and the ranking member have done to try to reach a resolution of this critical problem.

Thank you very much, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Jeffords.

I announced earlier that any questions or any statements that you might like to submit to the record, any subcommittee member may do so without objection.

Mr. Madigan, you are recognized.

OPENING STATEMENT OF HON. EDWARD R. MADIGAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. MADIGAN. Mr. Chairman, just very briefly, I want to thank you and Mr. Coleman for the time that the two of you have devoted to this issue over the last 6 months. I am very proud to be associated with you and the bill that is before us this morning. I want to express my appreciation to the two of you for all the work that has gone into this bill.

I yield back the balance of my time.

Mr. JONES of Tennessee. Thank you very much, Mr. Madigan.

Now I recognize Mr. Weaver for any statement he might have.

OPENING STATEMENT OF HON. JAMES WEAVER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OREGON

Mr. WEAVER. Thank you, Mr. Chairman.

I, too, want to join in the commendations of the chairman of this subcommittee, who is one of the most distinguished members of this House, for his fine work, the ranking minority member, Mr. Coleman, whose critical mind has always been helpful, and our distinguished chairman of the full committee and ranking member. I say with all due respect to these members that my understanding is my position hasn't been made quite clear enough.

I want to say at the outset that I strongly oppose any financial bailout of the Farm Credit System. I believe a bailout of the Farm Credit System would be a ghastly mistake unless the farmer borrowers are put in a position where they can raise their income to pay back the loans. Otherwise, it makes no sense whatsoever in bailing out a financial institution that will simply go into worse shape after the bailout.

Thank you, Mr. Chairman.

Mr. **Jones** of Tennessee. Thank you very much, Mr. Weaver.

Now I believe all subcommittee members have been recognized. Is there any other member of the Agriculture Committee that is sitting with us this morning who would like to make any sort of a statement?

Anyway, I do appreciate the presence of all who are here this morning.

I want to say at the outset again that this subcommittee has worked hard and long hours as well as staff dedication in putting together this bill. We have had the consultation and the assistance of not only the lawyers of our full committee but of the Department of Agriculture, of the Treasury Department, the Farm Credit Administration, the farm credit council, and all people who are involved in this critical problem. I do sincerely appreciate the dedication and help that all of you have contributed to this subcommittee in this endeavor to do something for rural America.

Now the first witness will be recognized, the Honorable Charles Sethness, Assistant Secretary for Domestic Finance, U.S. Department of the Treasury here in Washington.

Before Mr. Sethness begins, I want to say to him publicly that I do sincerely appreciate the effort that you, your colleagues that came with you to help us with the bill, and Secretary Baker for the dedication that you lent to us for your contributions.

Now you may proceed.

STATEMENT OF CHARLES O. SETHNESS, ASSISTANT SECRETARY, DOMESTIC FINANCE, U.S. DEPARTMENT OF THE TREASURY

Mr. **Sethness**. Thank you, Mr. Chairman.

To you and to the members of the subcommittee and those of the full committee who are here, I appreciate this opportunity to appear before you to discuss H.R. 3792. I would like to ask that my prepared remarks be submitted for the record but will try to summarize what is in them as quickly as I can.

Mr. **Jones** of Tennessee. Without objection, they will be, the entire statement will be a part of the record.

Mr. **Sethness**. I would like to join all the others in expressing my high regard and compliments to the full committee, the subcommittee, and the staff for a major effort in getting this bill drafted. It is a complex subject, and time has been very short. It's a superlative effort.

The administration, like the sponsors of H.R. 3792, seeks two prompt actions to help the Farm Credit System remain a viable lender for farmers and to reassure capital market investors. First, the Farm Credit System needs the legislative authority to mobilize fully its substantial earned surplus, to absorb operating losses and prudently manage troubled loan assets.

Second, we need to transform the FCA into an independent financial regulator that has the will and the tools to supervise the Farm Credit System effectively.

The bill seeks to address both these points. While we have not had time to subject the bill to close scrutiny, I believe that it incorporates most of the critical reforms. My written statement explains in some detail nine adjustments to the bill that we would recommend. I would like to give just a very brief summary of some of those issues now.

We believe that the Farm Credit Administration needs its existing authority to regulate surplus transfers, not just to set standards. One thing that we certainly don't want to do at this juncture is to reduce the authority of the FCA.

We also feel strongly that opening up a loophole to generally accepted accounting principles would be a grave mistake. One of the challenges that all of us, in trying to come to grips with this situation, have had is trying to get a good grip on some hard numbers. And I think it would be a terrible mistake to leave the opportunity for less than GAAP accounting to be applied in the future.

We also feel very strongly that to avoid possible floods of litigation that would slow down the process of getting things operating properly, this bill ought to reflect the same enforcement powers that other financial institution regulators have. There was an admirable attempt to simplify and clarify some very complicated language that exists in the other regulators' authorities, but the courts have long tested all of these; and people understand what they are. We believe it would be a mistake to suggest that there might be differences between what the FCA could do and other regulators are currently authorized to do.

We also think that it should be very clear that the Capital Corporation is an integral part of the Farm Credit System—not a separate borrower, but fully and clearly jointly and severably liable with all other system institutions for system borrowings.

We also think that the Capital Corporation, for fairness to all of the institutions that are going to be participating in this sharing of resources, should only acquire troubled loan assets at fair market value rather than the current value standard that is in the bill.

As a smaller point, we were unclear as to why FCA had had removed its authority to require surety bonds for employees of Farm Credit System institutions.

We do not think that the Capital Corporation should have the statutory authority to issue regulations and undertake enforcement actions. Part of the effort here is to separate an operating entity from a regulator. We think it would be a mistake to confuse those two roles again and run the risk that Farm Credit System local institutions would end up with two regulators rather than one.

We believe that the surplus buildup formulae that are in the bill are unnecessary and could make it more complicated for the Farm Credit System Capital Corporation to fully mobilize the earned surplus and would recommend a change in that as long as we do not lose the ability to regulate dividend payments.

Finally, on what I gather is frequently a contentious subject of mergers of system institutions, we would suggest two relatively modest changes to provide for mergers of like associations within a district when an overwhelming majority of the associations and their shareholders would like to have such a merger; and a second increase in merger authority to have two banks operating under the same title be able to be merged if one of them is in the process of becoming insolvent. We think that having to liquidate that institution would have strong negative effects on the borrowers and the investors. It would make an awful lot more sense to at least leave open the possibility of merging a failing bank for efficiency and effectiveness.

We are, of course, more than willing to assist the subcommittee and the staff in working on the language to make these adjustments, if you so suggest, and will be as available as we have tried to be in the past.

Finally, we, of course, note that the bill authorizes the Secretary of the Treasury to purchase obligations of the Farm Credit System Capital Corporation. We cannot support this part of the bill. We firmly believe that providing financial assistance now is the wrong approach at the wrong time, leading to a possible wrong result.

The Farm Credit System does not need the Government's financial support. It had $5.5 billion in earned surplus and $1.6 billion in loss reserves as of September 30.

We are also concerned that consideration of financial assistance could make it impossible to move the necessary reforms and restructurings as promptly as they are needed to reassure the system, its borrowers, and its investors.

In closing, the administration urges the subcommittee to act quickly to reform FCA and to enable the Farm Credit System to muster its own considerable resources to help farmer borrowers. We in turn are committed to an assessment of the financial assistance question once the necessary changes to FCS and FCA have been implemented.

Thank you, Mr. Chairman. I would be happy to answer questions.

[The prepared statement of Mr. Sethness appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Sethness. We do appreciate your being here and your statement.

If you will remain until we have heard all witnesses, then the subcommittee will ask you questions.

The next witness is the Honorable Frank Naylor, Under Secretary for Small Community and Rural Development of USDA.

Frank, we do appreciate your being here and your contribution you have made through many days of hard work with this subcommittee in getting this bill put together. Now you may proceed.

STATEMENT OF FRANK W. NAYLOR, JR., UNDER SECRETARY, SMALL COMMUNITY AND RURAL DEVELOPMENT, U.S. DEPARTMENT OF AGRICULTURE

Mr. NAYLOR. Thank you, Mr. Chairman.

I would like to join with my colleague in commending you particularly and Mr. Coleman, along with Chairman de la Garza and the ranking minority member, for sponsoring and working so diligently to bring before this subcommittee a very complex and difficult piece of legislation which was done in a very short time. You particularly, Mr. Chairman, I think, and Mr. Coleman and your staffs, are to be commended for carrying out this the very difficult task.

We stand ready to work with you and the subcommittee and the full committee on resolving and completing action on this legislation, particularly on the first two principal concerns which Mr. Sethness has addressed.

Mr. Chairman, the Department joins with the Treasury Department in our assessment of the technical aspects of the bill. Because of the highly technical nature of this legislation, we have relied very heavily on their superb expertise in this area, as has your own subcommittee.

We share the concern that the Farm Credit System remain a viable and effective lender, particularly during this coming year as we move into a new lending season and we recognize the importance of accomplishing that. We share in urging quick action on necessary reforms to the system needed to reassure borrowers, to make it possible for them to continue to obtain credit at reasonable rates, to manage effectively problem loans and work with producers in that area, and to add some trust and confidence to the stocks held by the various borrower members.

Mr. Chairman, we are prepared and ready to answer questions that you may have today. We look forward to working with you. We urge the prompt action on this legislation in the first two areas that we have discussed so that we may provide the reassurance that we believe is necessary on behalf of the system and its continued operations.

Mr. JONES of Tennessee. Thank you very much, Frank.

As I said to Mr. Sethness, if you will remain, we will get to the witnesses later after we have heard all of them.

The next witness is the Honorable Donald E. Wilkinson, Governor of the Farm Credit Administration. Don, we are proud that you are here. You may proceed.

STATEMENT OF DONALD E. WILKINSON, GOVERNOR, FARM CREDIT ADMINISTRATION

Mr. WILKINSON. Thank you very much, Mr. Chairman.

We, too, of the FCA appreciate very much this privilege of coming before this subcommittee on this important occasion.

We commend you, Mr. Chairman and Chairman de la Garza, Mr. Madigan, Mr. Coleman, members of the committee, for addressing this pressing problem, for developing this consensus legislation. We also would like to put in a very special word of appreciation and thanks to your staff, with whom we have had the privilege of cooperating so completely.

We appreciate the importance which you have attached to this issue of giving it prompt consideration and, hopefully, rapid implementation upon enactment. We pledge our cooperation in working with you every hour, if that is necessary.

I would like to specifically address just two points and then if possible, Mr. Chairman, have our Senior Deputy, Mr. Duncan, address the backup Federal assistance concept. We will do this briefly.

This bill provides for the establishment of a new Farm Credit System Capital Corporation designed to centralize and manage the distressed assets of the system's institutions and to receive and administer system financial self-help and outside financial assistance.

It is critical, in our estimation, to the success of this effort that further consideration is given to measures to strengthen the effectiveness of the Farm Credit System Capital Corporation. We believe this to be essential. Its board of directors will be extremely important in achieving the objective which we believe you have set forth here.

We further believe that the Farm Credit Administration as the regulator will be held accountable by the Congress to fulfill this intent of the Congress.

Specifically, therefore, Mr. Chairman and members of the committee, we recommend that authority be granted to the Chairman of the Farm Credit Administration to appoint the five Farm Credit System Capital Corporation board members from among the most qualified individuals available, with the understanding that the majority of these directors, three of them, may be outside directors who are not affiliated with the system. Further, we believe that FCA's Chief Executive Officer should appoint the Chairman of the Capital Corporation and that that individual serve as its chief executive officer.

The second point that I wish to touch on here this morning is that your bill provides for a restructuring of the Farm Credit Administration and expansions of its regulatory authorities to achieve additional strength and independence separate from the Farm Credit System. As you know, since February of this year, we have been urging Congress to enact the kinds of intermediate enforcement authorities that we have in the bill which we have submitted to you.

We recognize the need for establishing an appropriate arm's-length relationship between the Farm Credit Administration and the system which it regulates.

The legislation which we have submitted for your consideration suggests a board and a chief executive officer structure that we believe preserves the independence of the agency while assuring proper public accountability and arm's-length relations between the regulator and the regulated.

While we believe the provision in your bill making the chairman of the board and the chief executive officer subject to Presidential appointment and Senate confirmation for a 6-year term, is generally consistent with our objective of preserving independence, we believe that it would be more appropriate for the presidentially appointed board to select the chief executive officer of the Farm Credit Administration.

We have one additional concern in the bill before us today. That is the provision of establishing five permanent board members, for we believe that permanent board members of that number will weaken the chairman's ability to effectively administer the agency.

To avoid this kind of operational difficulty, which would be associated with full-time policymakers in a relatively small organization like the FCA, we would recommend for your consideration that four of those directors serve on a part-time basis.

We would further point out, Mr. Chairman, that our legislation, and we believe yours, would effectively sever any part-time directors from having any system affiliation.

[The prepared statement of Mr. Wilkinson appears at the conclusion of the hearing.]

Mr. WILKINSON. Mr. Chairman, I would like now, if I may, to ask our Senior Deputy Governor to address the issue of Federal assistance as we view it from the Farm Credit Administration. Mr. Duncan.

Mr. JONES of Tennessee. Mr. Duncan, you are recognized.

STATEMENT OF MARVIN DUNCAN, SENIOR DEPUTY GOVERNOR, FARM CREDIT ADMINISTRATION

Mr. DUNCAN. Mr. Chairman, let me echo the Governor's comments with regard to the support and assistance of this subcommittee that you chair, your good efforts, the efforts of your ranking minority member, Mr. Coleman, the efforts of the chairman of the Agriculture Committee, Mr. de la Garza, and those of the ranking minority member, Mr. Madigan. This has been a noble and a very strenuous effort on your part and a good effort.

Your legislation provides for backup Federal assistance in the form of a line of credit to the Farm Credit System Capital Corporation on terms and rates of interest subject to the discretion of the Secretary of the Treasury. We believe that your bill is consistent with the line of credit models that are contained in statute governing the Federal National Mortgage Association and the Student Loan Marketing Association. The Farm Credit Administration therefore supports this provision of your bill provided it is congressional intent that the terms and rates of interest of credit extended should be set by Treasury at a level that will protect system access to credit markets and protect the system's ability to fulfill its congressional mandate to provide sound and constructive credit to creditworthy farmers.

A line of credit at market rates of interest will not stop or slow the financial deterioration of the system or its individual institutions. It may, however, provide some confidence to the market by evidencing the Federal Government's concern.

Let me address very briefly one other subject of your legislation, that of borrower access to documents of banks and associations within the system. There are four areas that are addressed or that we feel should be addressed, that of access by borrowers to bylaws and charters and amendments of those banks and associations; access to stockholder lists by member borrowers, assuming that the lists will be used only for proper purposes; access to loan documents that the borrower has signed; and disclosure by the bank and association of interest rates and basic calculations to be sure the borrower understands how rates are set.

We are not suggesting an extension of regulation Z to commercial agricultural borrowers and lenders.

The Farm Credit Administration supports your bill's approach in these areas.

Finally, there are a number of specific and technical concerns that we will share with you and your staff as you refine this legislation. We support your efforts to achieve prompt consideration and enactment of this consensus legislation. We pledge ourselves to work with you toward this end.

Mr. JONES of Tennessee. Thank you very much, Mr. Duncan, for your statement and for the help that you have given this subcommittee.

The next witness is Mr. Gene L. Swackhamer, president of the Farm Credit Banks of Baltimore. Gene, we are delighted that you are here. You may be heard. I notice that Doug Sims, president of the St. Louis Bank for Cooperatives, is also with you. I don't know how you are going to share your time.

Mr. SWACKHAMER. Thank you, Mr. Chairman. We have one statement. We flipped a coin, and I'm not sure whether I won or lost, but Mr. Sims will give the statement, and I think I have to answer the questions.

Mr. JONES of Tennessee. Very good. Welcome, Doug, we're glad to have you.

STATEMENT OF DOUGLAS D. SIMS, PRESIDENT, ST. LOUIS BANK FOR COOPERATIVES, ST. LOUIS, MO, MEMBER, LEGISLATIVE COMMITTEE, FARM CREDIT COUNCIL, ACCOMPANIED BY GENE L. SWACKHAMER, PRESIDENT, FARM CREDIT BANKS OF BALTIMORE, BALTIMORE, MD

Mr. SIMS. Thank you, Mr. Chairman.

We appreciate the opportunity to appear before your subcommittee today and are most grateful for the leadership that you as chairman, Mr. de la Garza, Mr. Madigan, and Mr. Coleman have given to this important issue for farmers and their cooperatives.

We appreciate the dedication of the staff who work on this as well. We recognize the complexity of this issue as well as the controversial nature of this issue for you. We appreciate those efforts.

It says to us that this leadership is demonstrating a strong bipartisan support for the Farm Credit System and that you are looking for an urgent response to this important issue for farmers.

I have a prepared statement and would ask that that be entered for the record and will try to hit the high points of that in the interest of time, Mr. Chairman.

The Farm Credit System is in strong support of the intent and thrust of this legislation. We are very pleased at the issues that you have addressed in this bill. It addresses the strengthening of farmer-borrower rights, which farmers must clearly understand their rights and responsibilities in this important borrower-lender relationship.

It addresses the restructuring of the Farm Credit Administration and certainly investors, whether they be bondholders or farmers, we believe must have confidence in the regulator and the regulatory mechanism which oversees this system.

It addresses a mechanism for triggering financial assistance. Certainly that is important to us because we believe that mechanism will be needed.

It addresses the safeguarding of pooling of capital in the system banks. Certainly we believe that fairness and equity, as it relates to the contributing banks and their farmer borrowers, should be addressed in such a way that it does not penalize those farmers and borrowers in those districts.

It addresses provisions for allowing mergers or liquidations as appropriate based on the majority stockholder votes.

I think the Farm Credit Council views this issue as being the very essence of grassroots control and stockholder rights. And that's the member's right to vote.

It addresses the statutory continuation of a financial warehouse for nonaccrual loans. Certainly the existing Farm Credit System Capital Corporation is a tested self-help mechanism. We would expect it to serve an expanded function, as this bill addresses.

The bill provides for financial assistance. We are pleased with the maximum flexibility that that provides to the Secretary of the Treasury, because we believe financial assistance will be needed. Certainly that financial assistance and the amount of it is tied very closely to the income of farmers that was addressed so well earlier.

We continue to believe that the profitability of agriculture is the best way to keep the system's need for assistance at a minimum. Yet, we believe that assistance is necessary.

So, we are very pleased with the bill, Mr. Chairman. We do have a comment or two on about three areas. Those are the discretionary authorities of the Secretary of the Treasury over the terms and conditions for the repayment of any loan. The second is the composition of the Capital Corporation board of directors. The third is the role and responsibilities of a restructured Farm Credit Administration.

We have testified previously that financial assistance to the system will help us have a more flexible forbearance policy. It will help us ensure more reasonable interest rates for farmers and their cooperatives. It will help us allow a more orderly and manageable process as we deal with the selling of the inventoried properties. It will help us ease the acceleration on collection of delinquent loans. Lastly, it will help all farmer borrowers in the process as they try to deal with their own delivery mechanisms in a more timely and thoughtful mechanism.

The system would like to see current bill language modified for several reasons.

The first major area of concern relates to the authorities of the Secretary of the Treasury. These above benefits can only be achieved if favorable terms and conditions of repayment from the Government are available. Without that, it would not assist the Farm Credit System in assisting farmers and agriculture through the difficult years ahead.

We believe it is important to define such terms as reasonable rates of interest, viable organizations. As we have testified earlier, maintaining a viable system is essential to any proposal. It defeats the objectives of the system institutions if banks who contribute become either noncompetitive in their region or, worse yet, nonviable. Rates charged to farmer borrowers and their cooperatives need to be competitive in their geographic area.

The second area of concern is in the composition of the Capital Corporation board. The initial investment of the capital and the Capital Corporation represents the investment of the assets of farmer-borrower-stockholders and their cooperatives. The Capital Corporation's proposed new role will make it the most powerful corporation in the Farm Credit System. To place this key unit under the direction or control of a government board would have the effect of federalizing the Farm Credit System.

The Chairman of FCA would be appointed by the President and the Capital Corporation board would be appointed by the Chairman of FCA. Thus, both the FCA Chairman and the Capital Corporation board could become political appointees, inconsistent, we think, with the idea of the arm's length between the regulator and the regulated.

Certainly we would concur with the administration's view of not having two masters within the Farm Credit System to regulate the system banks. We view, like them, the Capital Corporation to be a system bank.

The third area and last area of concern lies with the Farm Credit Administration as an arm's-length regulator. We believe the function of the regulator must be detached from operational management and policy decisions and that FCA's primary role should be as a regulator-examiner, as other regulator-examiners, to ensure, in the public interest, the safety and soundness of the Farm Credit System institutions.

The legislation as we read it would continue much of FCA's past role involving it in operational and day-to-day business decisions through case-by-case prior approvals. We view this as being fundamentally inconsistent with the arm's-length regulator.

In conclusion, Mr. Chairman, we are very pleased with the legislation that this leadership has put forth. We believe action is needed in this session of Congress to avert two potential crises. One is the potential funding crisis that we are dealing with on a day-to-day basis. The second is the building financial crisis due to the non-accrual loans.

We thank you for this time and would be most pleased to work with you or your staff in dealing with any of these issues and are prepared to answer any questions today. Thank you.

[The prepared statement of Mr. Sims appears at the conclusion of the hearing.]

Mr. **Jones** of Tennessee. Thank you very much, Mr. Sims.

Now the subcommittee will proceed to question the witnesses. Mr. Coleman is recognized for 5 minutes—Mr. de la Garza, do you want to be recognized?

The **Chairman**. Would the gentleman yield to me?

Mr. **Jones** of Tennessee. Surely. You can be recognized if you want to.

The **Chairman**. I have a communication from the Farm Credit Banks of Texas that I would ask unanimous consent be inserted in the record at this point.

Mr. **Jones** of Tennessee. Without objection.

[The material follows:]

Farm Credit Banks of Texas,
Austin, TX, November 21, 1985.

Hon. de la Garza,
Longworth House Office Building, Washington, DC.

Dear Mr. de la Garza: Attached are two documents from Texas.

One represents suggestions concerning House 3792 that were developed November 19, 1985, by the Stockholder Advisory Committees of the Federal Land Bank, Federal Intermediate Credit Bank and Bank for Cooperatives. These committees are made up of directors from Farm Credit System associations and cooperatives.

We are submitting these on behalf of these committees for your consideration.

The other document represents additional thinking and suggestions from the Farm Credit Banks Board of Directors.

These were developed November 20, 1985 during our regular meeting in Austin, Texas, and are our items we ask that you consider concerning House 3792.

The Board of Directors attempted to define the term "reasonable amount." We find this very difficult to do. Our position is that we find it difficult to support an assessment that would cause us to have to raise our interest rates to our member/borrowers. Yet, at the same time, we recognize we are all severally liable for the system's bonds.

We hope you will allow us the prerogative of discussing "reasonable amount and viability standards" still further and communicating again with you concerning these.

Again, our primary responsibility is to Texas farmers and ranchers. To support legislation that is detrimental to them is certainly not our goal and we know, Mr. de la Garza, from your past record and statements it is not yours either.

Thank you for your consideration of the Texas Farm Credit Boards' position.

Sincerely,

Roy A. Seaberg, Jr.,
Chairman of the Board, Farm Credit Banks of Texas.

[Attachments follow:]

CONSIDERATIONS SUGGESTED BY TEXAS FARM CREDIT BOARD

CONCERNING HOUSE 3792

1. FARM CREDIT SYSTEM CAPITAL CORPORATION--All directors will be elected from District Boards that do not receive assistance from the Capital Corporation.

   Alternate or Fall-back Position--When government capital is injected into the Capital Corporation, then additional Board members are appointed by the Governor of the Farm Credit Administration from or representing the public sector.

2. The Farm Credit System Capital Corporation should be a vehicle to utilize System resources in a prudent, businesslike manner, consistent with sound banking practices, so that the likelihood of requiring infusion of public funds will be minimized.

   Accordingly, the Farm Credit System Capital Corporation should be authorized to hold loans and loan related assets only for the purposes of orderly liquidation and the stabilizing of asset values.

3. Assets purchased from institutions by the Farm Credit System Capital Corporation will be purchased at recovery values, as determined by policy established by the Farm Credit System Capital Corporation Board of Directors.

4. System levies shall be an investment in the Capital Corporation to be repaid with a reasonable rate of interest (deferred) after government capital is repaid.

5. The Farm Credit System Capital Corporation can draw funds from other System institutions by steps requiring stock purchases or assessments under guidelines set by the Farm Credit System Capital Corporation Board of Directors.

(Discussion--How can FCA help manage the Farm Credit System Capital Corporation and, at the same time, be an effective arms length regulator? In effect, as now, FCA would be regulating itself. Everybody--Congress, the Administration, the Farm Credit System--admits that an "incestuous" relationship is a major part of the problem in the past regulation of the Farm Credit System by FCA. Also, until government funds are infused into the Farm Credit System, the System should remain "privately managed and directed.")

Developed 11/20/85

On November 19, 1985, during a District Stockholders Advisory meeting of the FLBAs, PCAs, OFIs and Cooperatives along with members of the Texas District Board, the following legislative comments were discussed and are now being submitted for consideration.

LEGISLATIVE COMMENTS:

1. The district may be assessed for no more than .1 percent of loans outstanding per year in the form of an investment in the Capital Corporation not to exceed .25 percent of loans outstanding. A dividend on such investment will be established by the Capital Corporation board but in no event will be less than the average cost of debt of the FCS, determined annually. The dividend will be cumulative and not taxable until paid.
2. Loan loss reserves should be retained, not subject to transfer to the Capital Corporation or any other entity.
3. Setting of interest rates will be totally a district bank prerogative.
4. Approval power should be removed from FCA and their role limited to an FDIC type arms-length regulator.
5. The district director at-large should be elected at-large by the association stockholders.
6. Initially, the three board members of the Capital Corporation should be selected from the non-receiving districts.

   Three regions, consisting of four districts, should be established. One board member should be selected from each region for a six-year term. Selection should rotate every six years among districts within the three regions.
7. Establish separate Bank boards as proposed in Senate 1790.
8. Regulate FCSCC so that it neither becomes a holding company nor operates in competition with primary lenders.
9. Preserve the historic discount rights and privileges of Other Financing Institutions (OFIs) and do not jeopardize their investment in the Banks.

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The CHAIRMAN. The way it was transmitted, it is not too clear. I would like to have permission to present a more readable copy later in the day.

Mr. JONES of Tennessee. Without objection, the chairman will be permitted to revise or whatever is necessary for the material in the record.

The CHAIRMAN. Thank you.

Mr. JONES of Tennessee. Mr. Chairman, would you like to be recognized at this point?

The CHAIRMAN. No, Mr. Chairman, I would hope that you would proceed in the regular order with your subcommittee.

Mr. JONES of Tennessee. Mr. Madigan, do you want to be recognized at this point?

Mr. MADIGAN. In the regular order, Mr. Chairman.

Mr. JONES of Tennessee. Mr. Coleman is recognized for 5 minutes to question the witnesses.

Mr. COLEMAN. Thank you, Mr. Chairman.

I want to thank each of you personally and your staff and organizations. You, I think, dealt with us in a forthright manner and a good-faith manner in trying to work out the draft which we have introduced. I thank all of you for that excellent support.

I am sure that none of you are completely happy, but all of you seem to be consistent today in supporting the thrust of what we have done. And I think that that means we have a pretty good piece of legislation.

It is my understanding from staff that the question about whether or not this subcommittee or the full Ag Committee will have total jurisdiction of this subject matter has been, at least for the present time, resolved in favor of the Agriculture Committee, as the Parliamentarian yesterday referred it solely to our jurisdiction, with the understanding that after we have a markup session in full committee that he would reevaluate the contents as far as a potential sequential referral to the Banking Committee. So, we might keep that in mind as we mark up the bill.

Mr. Sethness, we have several entities now in the Federal Government which have been mentioned, Fannie Mae and Sallie Mae, who have similar relationships with the Treasury in a sense of a line of credit. Would you think that our Capital Corporation and its relationship with the Treasury under our bill would be consistent with the authority the Treasury now has with those other entities that I have mentioned?

Mr. SETHNESS. The authority in this bill as drafted is quite parallel to those available to Fannie Mae, Sallie Mae, and the Federal home loan banks; yes, sir.

Mr. COLEMAN. OK.

I have one question which I would like to have each organization respond to, or individuals. That is one that was touched on by Mr. Sims in his comments. That is the creation of the Capital Corporation board of directors. I would like to have each of you address the question of the appointment of the members of that Capital Corporation. We presently have the three members of the Capital Corporation appointed by the Chairman of the FCA, and from district boards, and two from outside the system; but they are appointed by the Chairman. I wonder if you would address the question as to whether or not you feel that this is consistent with an arm's-length regulator that we are trying to put in place. Is there any question, or should we refine this to require that the district boards that are represented on this Capital Corporation board of directors come from either contributing institutions or receiving institutions? And do you think that the Chairman of the FCA should appoint these members as an alternative only when there is in fact financial assistance provided by Treasury?

These are some issues that were discussed. I was wondering, just for the record, if you have a comment about either one of those proposals or suggestions or considerations? I think it is important as to how this Capital Corporation is made up and the feelings that you all have about it.

Mr. SETHNESS. Congressman Coleman, if I might start off, our concerns and interests in terms of how the board of the Capital Corporation is structured have to do with concepts rather than particularities of where people are appointed from or by whom. The goal is to make sure that the Capital Corporation is an integral part of the Farm Credit System and remains as such and is perceived as such both inside and outside the system.

The second general concept is that it must have the right kind of governance so that it can effectively carry out a very complicated and possibly extremely contentious set of things that are going to need to be done in a very short time period.

Mr. NAYLOR. Mr. Coleman, the Department shares Mr. Sethness' view on that structure. It is a complex, difficult and potentially contentious operation the Capital Corporation faces. The importance of recognizing it as an integral part of the system in all respects is critical. Obviously our objective is to have the best qualified and strongest board possible in place to carry out those mandates. But we have some flexibility in that regard.

Mr. COLEMAN. We have heard from the system sufficiently on this, from your testimony. Mr. Wilkinson, would you care to comment?

Mr. WILKINSON. Yes, I will be pleased to, Mr. Coleman.

The present bill indicates that the members of the board shall be appointed by the chairman of the chief executive officer of the Farm Credit Administration. It further indicates, however, that three shall be of those elected members from district boards of the Farm Credit System.

It does indicate that the Farm Credit Administration chief executive officer shall designate the chairman. I have indicated to you in my opening comments that we believe that this board is going to be the most important factor in the success of this entire legislative proposal. We recognize the interest of the system in having representation on this important board. We further indicate that we believe the Capital Corporation must be an integrated part of the Farm Credit System, not part of the Government. But we have indicated further that we believe that the Farm Credit Administration will be held accountable for the full success of this Capital Corporation's efforts. Therefore, we believe that the chief executive officer of the Farm Credit Administration should have the privilege or opportunity of selecting the best qualified individuals to this important board of directors and further, Mr. Coleman, that they should serve during the life of this statutory Capital Corporation.

Mr. COLEMAN. Thank you, Mr. Chairman. I, too, have to go to the Rules Committee and hope to be able to return before we finish our business. Thank you.

Mr. JONES of Tennessee. Thank you very much, Mr. Coleman, for your questioning and for your attendance.

The Chair now recognizes Mr. Weaver for 5 minutes of questioning.

Mr. WEAVER. Thank you, Mr. Chairman.

I am going to ask questions about the Farm Credit System Capital Corporation, which is the current device used to divest, setting up a corporation and giving them the bad loans, is the current device used to divest shaky financial institutions and bad loans and to dump the bad paper on the taxpayer. That's why I call the Farm Credit System Capital Corporation an acronym, FARCE, because that's all it is, is a farce, a way to get in the back door and make the taxpayer pay the fees for this situation.

Mr. Sethness, your comments, you say the administration opposes the financial bailout of the system, but you don't argue very strongly against it. The only real argument you use is that it is going to slow down the passage of this bill through the Congress.

Are you really saying that the administration wants this bill to pass without having to go on the record as agreeing to this bailout?

Mr. SETHNESS. No, sir; that is not what I am saying.

Mr. WEAVER. Well, let's hear you say you want no bailout at all, absolutely, categorically no financial bailout; you'll oppose that down the line.

Mr. SETHNESS. The administration's position has been quite clear and consistent for——

Mr. WEAVER. Let's hear it. Do you strongly oppose any bailout of the Farm Credit System, yes or no?

Mr. SETHNESS. We are prepared and willing to assess the need for the system to have Federal financial assistance at such time as the necessary restructurings and reforms of the Farm Credit System and FCA have been implemented.

Mr. WEAVER. So, what you're saying is yes, you'll do it, but you've just got to do it in your own good time.

Mr. SETHNESS. No, sir; we are saying that we will assess that need.

Mr. WEAVER. That sounds like the same language, Mr. Sethness.

Now, Mr. Sethness, if this bill in its present form passed into law, you could bail out the system with $30 billion, could you not, or more? Is there any limit here to the amount of paper you could buy from FARCE?

Mr. SETHNESS. The only limit is the discretion of the Secretary of the Treasury.

Mr. WEAVER. Right. So, it could by $30 billion, correct?

Mr. SETHNESS. That is theoretically true. It's fairly incomprehensible how a $70 billion institution could need 30 billion dollars' worth of assistance.

Mr. WEAVER. I'm not so sure, the way farmland values are falling, Mr. Sethness. You ought to go out to Iowa and take a look at them. I'm not so sure at all.

I remember my Dad being approached by insurance companies in Iowa in the 1930's, begging him to buy land for $5 and $10 an acre. So, don't be so sure, Mr. Sethness. Don't be so sure.

Mr. **Sethness**. The system and the FCA's own best estimates, as I understand them, at the moment, are that the expected losses over the next couple of years are in the area of $3 to $5.5 billion.

Mr. **Weaver**. And they have been impeccably right all along, haven't they, Mr. Sethness? They've got a good track record, don't they?

Mr. **Sethness**. There has been a certain lagtime recognizing the problems that they had.

Mr. **Weaver**. You endeared yourself to me with that one. [Laughter.]

Mr. Sethness, so, therefore, under these terms of this bill right now, we could have a $5 billion bailout, could we not, a $10 billion bailout?

Mr. **Sethness**. As you have already established, there is no limit other than the discretion of the Secretary——

Mr. **Weaver**. It could be a $10 billion bailout, could it not, yes?

Mr. **Sethness**. Under the terms of the bill, that is possible.

Mr. **Weaver**. It could be a $20 billion bailout?

Mr. **Sethness**. Yes, sir.

Mr. **Weaver**. A $30 billion bailout?

Mr. **Sethness**. Yes, sir.

Mr. **Weaver**. Thirty-one——

Mr. **Sethness**. Do I hear a bid for more than the total assets of the system?

Mr. **Weaver**. Mr. Sethness, do you speak for Secretary of the Treasury Baker? The words you say here, can we attribute these to speaking for the Secretary?

Mr. **Sethness**. I certainly hope so, sir.

Mr. **Weaver**. All right. The President? The President? Do you speak for the administration?

Mr. **Sethness**. That's my understanding.

Mr. **Weaver**. All right. Would the President veto this bill on the grounds of this financial bailout?

Mr. **Sethness**. I do not know.

Mr. **Weaver**. You don't say anywhere here that you won't use the authority. What do you think, in the time remaining to me, Mr. Sethness, what do you think about the philosophy of bailing out a financial institution like this, with billions of dollars, without the borrower being in any better position to repay the underlying loans?

Mr. **Sethness**. You pose an interesting hypothetical, which is that you would be providing Federal financial assistance to a situation which was getting worse and that the assistance wouldn't help. We do not believe that that would be the case here. In fact, we believe very strongly, and I have testified now several times to the effect that the system has a substantial amount of its own resources, which may well be enough to deal with the loss problems and troubled loan assets that the system has.

Mr. **Weaver**. My time has expired, Mr. Sethness. I thank you for your answers. But I will add in closing that, if farm land values continue to decline, those resources will go to nothing and actually be negative. Is that not correct, yes or no?

Mr. SETHNESS. There is some amount of decline in farm land values that could produce that result, yes, sir.

Mr. WEAVER. Thank you, sir.

Mr. JONES of Tennessee. Thank you very much, gentlemen.

The Chair recognizes Mr. Gunderson for 5 minutes.

Mr. GUNDERSON. Thank you, Mr. Chairman.

I hate to put the two of you on the spot, but I need to have an idea of what is, in terms of timeliness, worth our effort around here and what is not. Would the Department of the Treasury recommend a veto if this bill were placed on the President's desk?

Mr. SETHNESS. I am not in a position to comment on what the Treasury Department's position would be on that.

Mr. GUNDERSON. It sure would be helpful if we knew.

How about the Department of Agriculture, Frank?

Mr. NAYLOR. Mr. Gunderson, we, too, are not in a position to comment. As you know, we only received the bill yesterday. We have not had an opportunity to review it in detail or to put it through our normal evaluative process. I can't answer that question either at this moment.

Mr. GUNDERSON. Does the system have the authority to pool its resources under the present law, or do we need to expand the authority to accomplish such?

Mr. NAYLOR. Clearly the system has the potential and the capacity to do much of that without legislation. But it is extremely difficult and it requires a very complex concurrence procedure among the system's various components. Given the nature and the seriousness of the problem, and the timeliness needed here, and the ability to move funds in a timely and effective manner probably the only reasonable solution is the legislative one.

Mr. GUNDERSON. I would be interested in anyone's comment on this question. The Farm Credit System Capital Corporation, which is proposed in this bill, is it the intent of this Capital Corporation to be a part of the normal operations of the Farm Credit System? Or is it intended, rather, to be a very special, unique and seldom-used tool to provide assistance at any time in which a particular institution is not able to continue operations without this type of access?

Mr. SETHNESS. I think the intention is that it should be a unique institution to assist those local distressed districts that are most in need. I think that it would be used seldom, given current circumstances.

Mr. GUNDERSON. Are there any other comments? I think this is really one of the major issues that we face with this legislation.

Mr. SWACKHAMER. Mr. Gunderson, the proposal in the statute would take an existing corporation and vest it more completely in the Farm Credit Act. The existing Farm Credit System Capital Corporation is operational. It has been the vehicle by which the system institutions provided financial assistance to the Spokane Federal Intermediate Credit Bank and to the Omaha Federal Intermediate Credit Bank. It is the vehicle for not only providing financial assistance as a grant to them but also to acquire nonaccrual, nonperforming loans for more orderly workout——

Mr. GUNDERSON. Do you read it as part of the day-to-day operations of the system?

Mr. SWACKHAMER. We view it as an integral part of the Farm Credit System. That's why we took the position in the testimony that it should be subject to the same intermediate powers as the other banks, meaning that, if you approve those powers, the Farm Credit Administration would be able to remove directors, remove management, issue cease and desist orders, and otherwise regulate it to accomplish their accountability.

Mr. DUNCAN. Mr. Congressman, we believe, as evidenced in the House bill and indeed as evidenced in legislation we have prepared and suggested for introduction, that the Farm Credit System Capital Corporation referred to in the House bill is indeed a unique entity with particularly specific authorities and for a specific purpose, that is to be a workout bank for the system. Clearly, it is part of the system. But it is unique. The authorities are defined as that of a workout bank for troubled assets in the system.

Because of the unique nature of its role and the very large and difficult task ahead of it, we would assert that the Farm Credit Administration ought to have the authority, indeed needs the authority to appoint the members of that board of directors.

Mr. GUNDERSON. It can't be both, gentlemen. It has either got to be one or the other, and the board that governs it has to be determined by which way we go on that issue. Either it's a part of the Farm Credit System and its normal operations and operates on that basis with its general accounting practices and its board, or else it's not. I just think that we have got to resolve that issue before this bill moves.

Thank you, Mr. Chairman.

Mr. DUNCAN. I think that there is ample precedence, sir, for Government oversight on committees and boards where Federal assistance has been made available. I refer to the circumstance in New York and also that of the Chrysler Corp.

Mr. JONES of Tennessee. Thank you very much, Mr. Gunderson.

The Chair recognizes Mr. Glickman for 5 minutes of questioning.

Mr. GLICKMAN. Thank you, Mr. Chairman.

First of all, I want to compliment you and Mr. Madigan and Mr. de la Garza and Mr. Coleman for introducing a very competent and well put together bill, given an extremely adverse set of circumstances.

Mr. Sethness and Mr. Naylor, I would like to read you the first sentence of an AP story yesterday: "Federal land banks in Omaha, Wichita, and Jackson, MI, could face huge losses because of sharp declines in land values, a top official in the Nation's Farm Credit System said Wednesday."

Now, I find it very interesting—first of all, I must say that we are not talking about a hypothetical problem here. Everybody is kind of talking in this highfalutin manner about how we're going to make all these changes in the Farm Credit System. But as Mr. Weaver pointed out, we have got catastrophic land value declines going on out there. We have serious personal and financial problems occurring.

I almost feel that your statement is leading us on, it's not providing any resolution of the problem at all. You basically support the two parts of this bill that are what I call the easy parts, the reorganization of the system; and you support giving the Farm Credit Administration more authority. Fine. That's no big problem. I have no problem with those kinds of easy votes myself.

What I want to know from you is, what is your bottom line in financial support for the system? Everybody tells me that's the heart of what this legislative process is going to be. We're not going to pass a bill out of this committee that doesn't have that third part of the component in this bill, I can tell you that right now. Your statement says the system does not now need the Government's financial support in any fashion. Quoting the words of the leader of this country, who said, "If not us, who, and if not now, when," I ask you: When would they need the support? How long do we wait? What are you looking for before you provide that kind of financial support? Are we going to wait 3 months, 5 months, 7 months? Are you going to wait until this bill is passed? Are you going to wait for a rapid deterioration in farm values?

Or is this a ploy? Is what you're doing by this trying to squeeze the system and ultimately you will accept a line of credit assistance in a piece of legislation?

Either you or Mr. Naylor.

Mr. **SETHNESS**. There are a lot of questions embedded in that question. As to the core one, the bottom line of what our position is, Mr. Naylor and I have just finished trying to respond to what the bottom line is as best we can. And there really isn't any more we can say on that bottom line at this point now.

Mr. **GLICKMAN**. Will you recommend a veto? Will you recommend a veto of the legislation if it's passed out as it is right now, you or the Secretary of the Treasury or the Secretary of Agriculture?

Mr. **SETHNESS**. Mr. Naylor and I have both testified that we don't know. We have not gone through the departmental evaluative steps to come up with a position on veto or not.

Mr. **GLICKMAN**. This is not a new problem. This is not something that came up yesterday afternoon. It has been going on for weeks and weeks and weeks.

Mr. **VOLKMER**. Would the gentleman yield on that?

Mr. **GLICKMAN**. I will be glad to yield.

Mr. **VOLKMER**. If you would, when would they be prepared to take a position on this legislation, specific legislation?

I mean, we're going to be coming back the 2d of December. That is going to give you a whole week.

Mr. **NAYLOR**. Mr. Volkmer and Mr. Glickman, we are in the process of beginning to move your proposed legislation, which let's recognize, was just introduced; so, we knew exactly what we were talking about, noon yesterday. Let me remind you that the President and other officials have been involved in another activity this week. It is going to take us a little while to move the bill through for the purpose you requested.

We have indicated, Mr. Glickman, from the outset that the administration would be prepared to assess the need for specific financial assistance or additional Federal intervention once we had a solid piece of legislation dealing with these first two matters, so we had a basis for evaluation. Questions are also being raised on the farm income that are affected by the farm bill.

Mr. Glickman. What you are saying then, to clarify it, is that you want this bill passed unencumbered by the financial assistance section, and then you will make a judgment at some point next year whether you need the line of credit, whether you would support the line of credit?

Mr. Naylor. We have suggested this legislation may run into some problems from timely handling, both from other committee status and other questions that may arise with the financial component in it.

Mr. Glickman. That's our problem, Mr. Naylor——

Mr. Naylor. Of course.

Mr. Glickman. That's not your problem. I think we can handle that situation.

I just want to know sequentially what you're talking about you want to do here. Do you want us to pass the first two parts of the bill, not the third part of the bill, hold it, you will see what the financial condition of the Farm Credit System goes, and maybe next January, February, or March you're going to recommend a line of credit?

I think the farmers of this country deserve to know without playing games, what our positions are, here in the House and Senate as well as in the administration. I mean, it looks like we're playing this cat and mouse game on this bill. It certainly doesn't make any sense to the American farmer.

If it were your position just to go with parts one and two, then tell us. Then we can make our decision after that.

Mr. Naylor. Mr. Glickman, our position is stated in testimony earlier. We do recommend going with the first two parts. We will commence the assessment process with or without that being done. But we recommend to you that the first two parts be passed and we get those in place. Then we can begin to take the corrective action necessary to get this system back into a position to serve farmers effectively.

Mr. Glickman. Thank you.

Are you going to go around for another set of questions?

Mr. Jones of Tennessee. Without objection, the gentleman is recognized for an additional minute.

Mr. Glickman. For 1 additional minute I would ask unanimous consent. I would be glad to yield to Mr. Madigan.

Mr. Madigan. I thank the gentleman for yielding.

In the drafting of this legislation we drafted a former lawyer from Texas, Mr. de la Garza, to be involved in this to help us with the drafting. We think he's a pretty good lawyer. And it's my understanding or my impression at this point that what we are talking about is semantics, that what the people at the table are saying is, if this is done, we'll assess the need for some financial assistance. And what the legislation as drafted by the chairman says is, we're going to do this, and then we're also going to provide you with the ability to provide that financial assistance if you determine that it's necessary. It's entirely at the Secretary's discretion. That's my understanding of how it is drafted.

I would ask Mr. Naylor, if you understand this to be drafted entirely at the Secretary's discretion and in fact to be quite flexible.

Mr. **Glickman**. And as you answer, remember Mr. Sethness' line in his statement is that he says this provision in the bill is inappropriate on two counts.

Mr. **Naylor**. To specifically answer Mr. Madigan's question, it appears that the Secretary does have full discretion in the proposal that is in the bill before you today.

Mr. **Madigan**. If the gentleman would yield——

Mr. **Glickman**. Let me just ask. Is that what you think, Mr. Sethness? If you think it's total——

Mr. **Sethness**. That is what the bill says, yes. It's totally at the Secretary's discretion.

Mr. **Glickman**. So, you don't oppose that provision of the bill?

Mr. **Madigan**. I think, if the gentleman will yield, what they are saying is they don't support it and they don't want to go on record here as answering all these questions about vetos and all those other things because some very principal players are out of the country.

I understand that. I mean, if somebody working for me was making decisions and committing me to things while I was out of the country, I would probably be a little bit upset when I got back.

I want to ask you again, Mr. Naylor, if you think this is completely flexible as far as the secretarial discretion is concerned.

Mr. **Naylor**. It is our view that it is fully discretionary to the Secretary, yes, Mr. Madigan.

Mr. **Madigan**. I thank the gentleman for yielding.

Mr. **Glickman**. Thank you.

Mr. **Jones** of Tennessee. Thank you, gentlemen.

The Chair recognizes Mr. Cooper Evans for 5 minutes of questioning.

Mr. **Evans** of Iowa. Thank you, Mr. Chairman.

Mr. Sethness, we are just delighted to have you with us this morning. I was fascinated by your testimony. We don't very often get an opportunity to discuss issues like this with representatives of the Treasury. I think it is perhaps a mistake that we have not had that opportunity in the past.

Since you are here, if you will excuse me, I am going to sort of focus on you for my 5 minutes here and try to clarify several points. One, in your testimony I was very much interested in your remarks about the same enforcement powers. I think that is a matter that certainly needs the attention of the committee. I sort of understand why we wandered off the precedent set by other agencies. But that's a very detailed technical subject for this subcommittee to get into.

What I am asking you at this point is, is there available from Treasury some statements of the specific changes that you think are important, or could there be?

Mr. **Sethness**. There is language for those provisions available.

Mr. **Evans** of Iowa. I would certainly like to have it.

Mr. **Sethness**. Some of the staff already has it.

Mr. **Evans** of Iowa. Made available to me, if that's possible at some point in the next week.

Mr. **Sethness**. Certainly.

[The information follows:]

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

November 26, 1985

Dear Mr. Chairman:

At the Subcommittee hearing on the Farm Credit System you asked me to supply the enforcement language employed by all other bank and thrift institution regulators. I have enclosed that draft language, incorporating the words "Farm Credit Administration" where appropriate and adding the "gross negligence" standard where it was inserted in H.R. 3792.

I strongly urge the Subcommittee to substitute this language for Section 204 of H.R. 3792. Section 204's revision and edit of the technical banking enforcement language -- while a good effort at a restatement -- could produce extensive litigation when FCA sought to use its new powers. None of us want FCA's enforcement actions to bog down. But I fear that would be the result because the courts would have to consider countless arguments about what the Congress intended when it rephrased the statutory powers that had been granted the other financial regulators. I suspect this is a case of "if it ain't broke, don't fix it."

We are, of course, ready and willing to assist with language for the other items I mentioned in my testimony. The Administration shares your strong interest in making sure the new FCA is an effective regulator and that the FCS has the self-help authority it needs.

I have sent a similar letter to Chairman Ed Jones, Mr. Ed Madigan, Mr. Tom Coleman, and Mr. Cooper Evans.

Sincerely,

Charles O. Setheness
Assistant Secretary
(Domestic Finance)

The Honorable
E. de la Garza
Chairman
Committee on Agriculture
U.S. House of Representatives
Washington, D.C. 20515

Enclosure

SEC. 5. ENFORCEMENT POWERS OF FARM CREDIT ADMINISTRATION:

Title IV of the Farm Credit Act of 1971 (12 U.S.C. subchapter IV) is hereby amended by adding a new Part F to read as follows"

Sec. 4.34. "(a) Cease-and-desist proceedings -

(1) If, in the opinion of the Farm Credit Administration, any institution in the Farm Credit System, or any director, officer, employee, agent, or other person participating in the conduct of the affairs of such an institution is engaging or has engaged, or the Farm Credit Administration has reasonable cause to believe that the institution or any director, officer, employee, agent, or other person participating in the conduct of the affairs of such institution is about to engage, in an unsafe or unsound practice in conducting the business of such institution, or is violating or has violated, or the Farm Credit Administration has reasonable cause to believe that the institution or any director, officer, employee, agent, or other person participating in the conduct of the affairs of such institution is about to violate, a law, rule, or

regulation, or any condition imposed in writing by the Farm Credit Administration in connection with the granting of any application or other request by the institution or any written agreement entered into with the Farm Credit Administration, the Farm Credit Administration may issue and serve upon the institution or such director, officer, employee, agent, or other person a notice of charges in respect thereof. The notice shall contain a statement of the facts constituting the alleged violation or violations or the unsafe or unsound practice or practices, and shall fix a time and place at which a hearing will be held to determine whether an order to cease and desist therefrom should issue against the institution or the director, officer, employee, agent, or other person participating in the conduct of the affairs of such institution. Such hearing shall be fixed for a date not earlier than thirty days nor later than sixty days after service of such notice unless an earlier or a later date is set by the Farm Credit Administration at the request of any party so served. Unless the party or parties so served shall appear at the hearing personally or by a duly authorized representative, they shall be deemed to have consented to the issuance of the cease-and-desist order. In the event of such consent, or if upon the record made at any such hearing, the Farm Credit Administration shall find that any violation or unsafe or unsound practice specified in the notice of charges has been established, the Farm Credit Administration may issue and serve upon the institution or the director, officer, employee, agent, or other person participating in the conduct of the affairs of such institution an order to cease and desist from any such violation or practice. Such order may, by provisions which may be mandatory or otherwise, require the institution or its directors, officers, employees, agents, and other persons participating in the conduct of the affairs of such institution to cease and desist from the same, and, further, to take affirmative action to correct the conditions resulting from any such violation or practice.

(2) A cease-and-desist order shall become effective at the expiration of thirty days after the service of such order upon the institution or other person concerned (except in the case of a cease-and-desist order issued upon consent, which shall become effective at the time specified therein), and shall remain effective and enforceable as provided therein except to such extent as it is stayed, modified, terminated, or set aside by action of the Farm

Credit Administration or a reviewing court.

(b) Temporary cease-and-desist orders

(1) Whenever the Farm Credit Administration shall determine that the violation or threatened violation or the unsafe or unsound practice or practices, specified in the notice of charges served upon the institution or any director, officer, employee, agent, or other person participating in the conduct of the affairs of such institution pursuant to paragraph (1) of subsection (a) of this section, or the continuation thereof, is likely to cause insolvency or substantial dissipation of assets or earnings of the institution, or is likely to seriously weaken the condition of the institution or otherwise seriously prejudice the interests of the investors in Farm Credit System obligations or shareholders in the institution prior to the completion of the proceedings conducted pursuant to paragraph (1) of subsection (a) of this section, the Farm Credit Administration may issue a temporary order requiring the institution or such director, officer, employee, agent, or other person to cease and desist from any such violation or practice and to take affirmative action to prevent such insolvency, dissipation, condition, or prejudice

pending completion of such proceedings. Such order shall become effective upon service upon the institution or such director, officer, employee, agent, or other person participating in the conduct of the affairs of such institution and, unless set aside, limited, or suspended by a court in proceedings authorized by paragraph (2) of this subsection, shall remain effective and enforceable pending the completion of the administrative proceedings pursuant to such notice and until such time as the Farm Credit Administration shall dismiss the charges specified in such notice, or if a cease-and-desist order is issued against the institution or such director, officer, employee, agent, or other person, until effective date of such order.

(2) Within ten days after the institution concerned or any director, officer, employee, agent, or other person participating in the conduct of the affairs of such institution has been served with a temporary cease-and-desist order, the institution or such director, officer, employee, agent, or other person may apply to the United States district court for the judicial district in which the home office of the institution is located, or the United States District Court for the District of Columbia, for an

injunction setting aside, limiting, or suspending the enforcement, operation, or effectiveness of such order pending the completion of the administrative proceedings pursuant to the notice of charges served upon the institution or such director, officer, employee, agent, or other person under paragraph (1) of subsection (a) of this section, and such court shall have jurisdiction to issue such injunction.

(c) Temporary cease-and-desist order; enforcement

In the case of violation or threatened violation of, or failure to obey, a temporary cease-and-desist order issued pursuant to paragraph (1) of subsection (b) of this section, the Farm Credit Administration may apply to the United States district court, or the United States court of any territory, within the jurisdiction of which the home office of the institution is located, for an injunction to enforce such order, and, if the court shall determine that there has been such violation or threatened violation or failure to obey, it shall be the duty of the court to issue such injunction.

(d) Suspension or removal of director or officer

(1) Whenever, in the opinion of the Farm Credit

Administration, any director or officer of any institution in the Farm Credit System has committed any violation of law, rule, or regulation or of a cease-and-desist order which has become final, or has engaged or participated in any unsafe or unsound practice in connection with the institution, or has committed or engaged in any act, omission, or practice which constitutes a breach of his fiduciary duty as such director or officer, and the Farm Credit Administration determines that the institution has suffered or will probably suffer substantial financial loss or other damage or that the interests of its shareholders or investors in Farm Credit System obligations could be seriously prejudiced by reason of such violation or practice or breach of fiduciary duty, or that the director or officer has received financial gain by reason of such violation or practice or breach of fiduciary duty, and that such violation or practice or breach of fiduciary duty is one involving personal dishonesty on the part of such director or officer, or one which demonstrates a willful [, grossly negligent,] or continuing disregard for the safety or soundness of the bank, the Farm Credit Administration may serve upon such director or officer a written notice of its intention to remove him from office.

(2) Whenever, in the opinion of the Farm Credit Administration, any director or officer of an institution in the Farm Credit System, by conduct or practice with respect to another institution in the Farm Credit System or other business institution which resulted in substantial financial loss or other damage, has evidenced either his personal dishonesty or a willful [, grossly negligent,] or continuing disregard for its safety and soundness and, in addition, has evidenced his unfitness to continue as a director or officer, and whenever, in the opinion of the Farm Credit Administration, any other person participating in the conduct of the affairs of an institution in the Farm Credit System, by conduct or practice with respect to such institution or other institution in the Farm Credit System or other business institution which resulted in substantial financial loss or other damage, has evidenced either his personal dishonesty or a willful [, grossly negligent,] or continuing disregard for its safety and soundness and, in addition, has evidenced his unfitness to participate in the conduct of the affairs of such institution, the Farm Credit Administration may serve upon such director, officer, or other person a written notice of its intention to remove him from office or to prohibit his further participation in any manner in

the conduct of the affairs of the institution.

(3) In respect to any director or officer of an institution in the Farm Credit System or any other person referred to in paragraph (1) or (2) of this subsection, the Farm Credit Administration may, if it deems it necessary for the protection of the institution or the interests of its shareholders and the investors in the Farm Credit System obligations, by written notice to such effect served upon such director, officer, or other person, suspend him from office or prohibit him from further participation in any manner in the conduct of the affairs of the institution. Such suspension or prohibition shall become effective upon service of such notice and, unless stayed by a court in proceedings authorized by subsection (e) of this section, shall remain in effect pending the completion of the administrative proceedings pursuant to the notice served under paragraph (1) or (2) of this subsection and until such time as the Farm Credit Administration shall dismiss the charges specified in such notice, or, if an order of removal or prohibition is issued against the director or officer or other person, until the effective date of any such order. Copies of any such notice shall also be served upon the institution of which he is a director or officer or

in the conduct of whose affairs he has participated.

(4) A notice of intention to remove a director, officer, or other person from office or to prohibit his participation in the conduct of the affairs of an institution in the Farm Credit System, shall contain a statement of the facts constituting grounds therefor, and shall fix a time and place at which a hearing will be held thereon. Such hearing shall be fixed for a date not earlier than thirty days nor later than sixty days after the date of service of such notice, unless an earlier or a later date is set by the Farm Credit Administration at the request of (A) such director or officer or other person, and for good cause shown, or (B) the Attorney General of the United States. Unless such director, officer, or other person shall appear at the hearing in person or by a duly authorized representative, he shall be deemed to have consented to the issuance of an order of such removal or prohibition. In the event of such consent, or if upon the record made at any such hearing the Farm Credit Administration shall find that any of the grounds specified in such notice have been established, the Farm Credit Administration may issue such orders of suspension or removal from office, or prohibition from participation in the

conduct of the affairs of the institution, as it may deem appropriate. A copy of an order issued under this subsection shall be served upon the institution concerned. Any such order shall become effective at the expiration of thirty days after service upon such institution and the director, office, or other person concerned (except in the case of an order issued upon consent, which shall become effective at the time specified therein). Such order shall remain effective and enforceable except to such extent as it is stayed, modified, terminated, or set aside by action of the agency or a reviewing court.

(e) Stay of suspension and/or prohibition of director or officer

Within ten days after any director, officer, or other person has been suspended from office and/or prohibited from participation in the conduct of the affairs of an insured bank under subsection (d)(3) of this section, such director, officer, or other person may apply to the United States district court for the judicial district in which the home office of the institution is located, or the United States District Court for the District of Columbia, for a stay of such suspension and/or prohibition pending the completion of the administrative proceedings pursuant to the notice served upon such director, officer, or other person under subsection (d)(1) or (d)(2) of this section, and such court shall have jurisdiction to stay such suspension and/or prohibition.

(f) Suspension or removal of director or officer charged with felony

(1) Whenever any director or officer of an institution in the Farm Credit System, or other person participating in the conduct of the affairs of such institution, is charged in any information, indictment, or complaint authorized by a United States attorney, with the commission of or participation in a crime involving dishonesty or breach of trust which is punishable by imprisonment for a term exceeding one year under State or Federal law, the Farm Credit Administration may, if continued service or participation by the individual may pose a threat to the interests of the institution's shareholders or the investors in the Farm Credit System obligations or may threaten to impair public confidence in the institution or Farm Credit System, by written notice served upon such director, officer, or other person, suspend him from office or prohibit him from further participation in

any manner in the conduct of the affairs of the institution. A copy of such notice shall also be served upon the institution. Such suspension or prohibition shall remain in effect until such information, indictment, or complaint is finally disposed of or until terminated by the Farm Credit Administration. In the event that a judgment of conviction with respect to such crime is entered against such director, office, or other person, and at such time as such judgment is not subject to further appellate review, the Farm Credit Administration may, if continued service or participation by the individual may pose a threat to the interests of the institution's shareholders or the investors in Farm Credit System obligations or may threaten to impair public confidence in the institution or the Farm Credit System, issue and serve upon such director, officer, or other person an order removing him from office or prohibiting him from further participation in any manner in the conduct of the affairs of the institution except with the consent of the Farm Credit Administration. A copy of such order shall also be served upon such institution, whereupon such director or officer shall cease to be a director or officer of such institution. A finding of not guilty or other disposition of the charge shall not preclude the Farm Credit

Administration from thereafter instituting proceedings to remove such director, officer, or other person from office or to prohibit further participation in Farm Credit System affairs, pursuant to paragraph (1), (2), or (3) of subsection (d) of this section. Any notice of suspension or order of removal issued under this paragraph shall remain effective and outstanding until the completion of any hearing or appeal authorized under paragraph (3) hereof unless terminated by the Farm Credit Administration.

(2) If at any time, because of the suspension or removal of one or more directors pursuant to subsections (d), (e), or (f) above, there shall be on the board of directors of a System institution less than a quorum of directors not so suspended, the Chairman shall appoint persons to serve temporarily as directors in their place and stead so as to establish a quorum until such time as those who have been removed are reinstated or their respective successors are duly elected and take office.

(3) Within thirty days from service of any notice of suspension or order of removal issued pursuant to paragraph (1) of this subsection, the director, officer, or other person concerned may request in

writing an opportunity to appear before the Farm Credit Administration to show that the continued service to or participation in the conduct of the affairs of the institution by such individual does not, or is not likely to, pose a threat to the interests of the institution's shareholders or the investors in Farm Credit System obligations. Upon receipt of any such request, the Farm Credit Administration shall fix a time (not more than thirty days after receipt of such request, unless extended at the request of the concerned director, officer, or other person) and place at which the director, officer, or other person may appear, personally or through counsel, before the Chairman of the Farm Credit Administration or designated employees of the Farm Credit Administration to submit written materials (or, at the discretion of the Farm Credit Administration, oral testimony) and oral argument. Within sixty days of such hearing, the Farm Credit Administration shall notify the director, officer, or other person whether the suspension or prohibition from participation in any manner in the conduct of the affairs of the institution will be continued, terminated, or otherwise modified, or whether the order removing said director, officer or other person from office or prohibiting such individual from further participation in any manner in the conduct of the affairs of the institution will be rescinded or otherwise modified. Such notification shall contain a statement of the basis for the Farm Credit Administration's decision, if adverse to the director, officer or other person. The Farm Credit Administration is authorized to prescribe such rules as may be necessary to effectuate the purposes of this subsection.

(g) Hearings and judicial review

(1) Any hearing provided for in this section (other than the hearing provided for in subsection (f)(3) of this section) shall be held in the Federal judicial district or in the territory in which the home office of the institution is located unless the party afforded the hearing consents to another place, and shall be conducted in accordance with the provisions of chapter 5 of title 5. Such hearing shall be private, unless the Farm Credit Administration, in its discretion, after fully considering the views of the party afforded the hearing, determines that a public hearing is necessary to protect the public interest. After such hearing, and within ninety days after the Farm Credit Administration has notified the parties that

the case has been submitted to it for final decision, it shall render its decision (which shall include findings of fact upon which its decision is predicated) and shall issue and serve upon each party to the proceeding an order or orders consistent with the provisions of this section. Judicial review of any such order shall be exclusively as provided in this subsection (g). Unless a petition for review is timely filed in a court of appeals of the United States, as hereinfter provided in paragraph (2) of this subsection, and thereafter until the record in the proceeding has been filed as so provided, the Farm Credit Administration may at any time, upon such notice and in such manner as it shall deem proper, modify, terminate, or set aside any such order. Upon such filing of the record, the Farm Credit Administration may modify, terminate, or set aside any such order with permission of the court.

(2) Any party to the proceeding, or any person required by an order issued under this section to cease and desist from any of the violations or practices stated therein, may obtain a review of any order served pursuant to paragraph (1) of this subsection (other than an order issued with the consent of the System institution or the director or

officer or other person concerned, or an order issued under paragraph (1) of subsection (f) of this section) by the filing in the court of appeals of the United States for the circuit in which the home office of the institution is located, or in the United States Court of Appeals for the District of Columbia Circuit, within thirty days after the date of service of such order, a written petition praying that the order of the Farm Credit Administration be modified, terminated, or set aside. A copy of such petition shall be forthwith transmitted by the clerk of the court to the Farm Credit Administration, and thereupon the Farm Credit Administration shall file in the court the record in the proceeding, as provided in section 2112 of title 28. Upon the filing of such petition, such court shall have jurisdiction, which upon the filing of the record shall except as provided in the last sentence of said paragraph (1) be exclusive, to affirm, modify, terminate, or set aside, in whole or in part, the order of the agency. Review of such proceedings shall be had as provided in chapter 7 of title 5. The judgment and decree of the court shall be final, except that the same shall be subject to review by the Supreme Court upon certiorari, as provided in section 1254 of title 28.

(3) The commencement of proceedings for judicial review under paragraph (2) of this subsection shall not, unless specifically ordered by the court, operate as a stay of any order issued by the Farm Credit Administration.

(h) Jurisdiction and enforcement; penalty

(1) The Farm Credit Administration may in its discretion apply to the United States district court, or the United States court of any territory, within the jurisdiction of which the home office of the institution is located, for the enforcement of any effective and outstanding notice or order issued under this section, and such courts shall have jurisdiction and power to order and require compliance herewith; but except as otherwise provided in this section no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under this section, or to review, modify, suspend, terminate, or set aside any such notice or order.

(2)(i) Any institution in the System which violates or any officer, director, employee, agent, or other person participating in the conduct of the affairs of such an institution who violates the terms of any order which has become final and was issued pursuant to subsection (a) or (b) of this section, shall forfeit and pay a civil penalty of not more than $1,000 per day for each day during which such violation continues: Provided, That the Farm Credit Administration may, in its discretion, compromise, modify, or remit any civil money penalty which is subject to imposition or has been imposed under such authority. The penalty may be assessed and collected by the Farm Credit Administration by written notice.

(ii) In determining the amount of the penalty the Farm Credit Administration shall take into account the appropriateness of the penalty with respect to the size of financial resources and good faith of the System institution or person charged, the gravity of the violation, the history of previous violations, and such other matters as justice may require.

(iii) The System institution or person assessed shall be afforded an opportunity for a hearing by the Farm Credit Administration, upon request made within ten days after issuance of the notice of assessment. In such hearing all issues shall be determined on the record pursuant to section 554 of title 5. The Farm Credit Administration determination shall be made by final order which may be reviewed only as provided in subparagraph (iv). If no hearing is requested as herein provided, the assessment shall constitute a final and unappealable order.

(iv) Any System institution or person against whom an order imposing a civil money penalty has been entered after a Farm Credit Administration hearing under this section may obtain review by the United States court of appeals for the circuit in which the home office of the System institution is located, or the United States Court of Appeals for the District of Columbia Circuit, by filing a notice of appeal in such court within twenty days from the service of such order, and simultaneously sending a copy of such notice by registered or certified mail to the Farm Credit Administration. The Farm Credit Administration shall promptly certify and file in such Court the record upon which the penalty was imposed, as provided in section 2112 of title 28. The findings of the Farm Credit Administration shall be set aside if found to be unsupported by substantial evidence as provided by section 706(2)(E) of title 5.

(v) If any System institution or person fails to pay an assessment after it has become a final and unappealable order, or after the court of appeals has entered final judgment in favor of the Farm Credit Administration, the Farm Credit Administration shall refer the matter to the Attorney General, who shall recover the amount assessed by action in the appropriate United States district court. In such action, the validity and appropriateness of the final order imposing the penalty shall not be subject to review.

(vi) The Farm Credit Administration shall promulgate regulations establishing procedures necessary to implement this paragraph.

(vii) All penalties collected under authority of this section shall be covered into the Treasury of the United States.

(i) Penalties

Any director or officer, or former director or officer of a System institution, or any other person, against whom there is outstanding and effective any notice or order (which is an order which has become final) served upon such director, officer, or other person under subsections (d)(3), (d)(4), or (f) of this section, and who (i) participates in any manner in the conduct of the affairs of the institution involved, or directly or indirectly solicits or procures, or transfers or attempts to transfer, or votes or attempts to vote, any proxies, consents, or authorizations in respect of any voting rights in such institution, or (ii) without the prior written approval of the Farm Credit Administration, votes for a director, serves or acts as a director, officer, or employee of any System institution, shall upon conviction be fined not more than $5,000 or imprisoned for not more than one year, or both.

(j) Definitions

As used in this Part (1) the terms "cease-and-desist order which has become final" and "order which has become final" mean a cease-and-desist order, or an order, issued by the Farm Credit Administration with the consent of the System institution or the director or officer or other person concerned, or with respect to which no petition for review of the action of the Farm Credit Administration has been filed and perfected in a court of appeals as specified in paragraph (2) of subsection (g) of this section, or with respect to which the action of the court in which said petition is so filed is not subject to further review by the Supreme Court of the United States in proceedings provided for in said paragraph, or an order issued under paragraph (1) or (3) of subsection (f) of this section; (2) the term "violation" includes without limitation any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, or aiding or abetting a violation; (3) the terms "institution in the System," "System institution," and "institution" mean all institutions enumerated in section 1.2 of the Farm Credit Act of 1971, as amended, any service organization chartered pursuant to Part D of Title IV, and the Capital Corporation; and (4) the term "unsafe or unsound banking practice" shall have the meaning given to it by the Farm Credit Administration by regulations, rule, or order.

(k) Notice of service

Any service required or authorized to be made by the Farm Credit Administration under this section may be made by registered mail, or in such other manner reasonably calculated to give actual notice as the Farm Credit Administration may by regulation or otherwise provide.

(l) Ancillary provisions; subpena power, etc.

In the course of or in connection with any proceeding under this section or any examination or investigation under section of this Act, the Farm Credit Administration or any designated representative thereof, including any person designated to conduct any hearing under this section, shall have the power to administer oaths and affirmations, to take or cause to be taken depositions, and to issue, revoke, quash, or modify subpenas and subpenas duces tecum; and the Farm Credit Administration is empowered to make rules and regulations with respect to any such proceedings, claims, examinations, or investigations. The attendance of witnesses and the production of documents provided for in this subsection may be required from any place in any State or in any territory or other place subject to the jurisdiction of the United States at any designated place where such proceeding is being conducted. The Farm Credit Administration or any party to proceedings under this section may apply to the United States District Court for the District of Columbia, or the United States district court for the judicial district or the United States court in any territory in which such proceeding is being conducted, or where the witness resides or carries on business, for enforcement of any subpena or subpena duces tecum issued pursuant to this subsection, and such courts shall have jurisdicition and power to order and require compliance therewith. Witnesses subpenaed under this subsection shall be paid the same fees and mileage that are paid witnesses in the district courts of the United States. Any court having jurisdiction of any proceeding instituted under this section by a System institution or a director or officer thereof, may allow to any such party such reasonable expenses and attorneys' fees as it deems just and proper; and such expenses and fees shall be paid by the System institution or from its assets. Any person who willfully shall fail or refuse to attend or testify or to answer any lawful inquiry or to produce books, papers, correspondence, memoranda, contracts, agreements, or other records, if in such person's power so to do, in obedience to the subpena of the Farm Credit Administration, shall be guilty of a misdemeanor and, upon conviction, shall be subject to a fine of not more than $1000 or to imprisonment for a term of not more than one year or both.

Mr. EVANS of Iowa. Second, you raised the matter of the Capital Corporation acquiring assets at fair market value as opposed to the way the bill provides, which, as I recall, is the current value carried on the books, or something close to that.

Mr. SETHNESS. The current value as determined at the date of the last examination——

Mr. EVANS OF Iowa. Yes.

Mr. SETHNESS. Which could be quite stale at the time——

Mr. EVANS of Iowa. Which could be many years old in some instances, I suspect, when they looked at that last value.

How would you suggest that fair market value be established in connection with the transfer of some of these assets?

Mr. SETHNESS. I would think that some form of current appraisal——

Mr. EVANS of Iowa. By independent outside appraisers, that sort of thing?

Mr. SETHNESS. I have to confess that I am not enough of an expert on how you go about valuing farm properties in these days——

Mr. EVANS of Iowa. But fair market value determined by relatively expert noninterested parties, is that essentially what you're saying?

Mr. SETHNESS. Yes, sir.

Mr. EVANS of Iowa. I am curious also about the long-term problem of the system and the way you might view it as an Assistant Secretary for Domestic Policy. There are a variety of reasons that we find ourselves in this dilemma. One of them, in my judgment, is that there was not available to the Farm Credit Administration and the Governor at an early date a centralized reserve of funds that he could use to bring to focus on the points of crisis. I think the bill does a very good job of outlining an approach to the current crisis. But I am looking down the road 20 or 30 years at provisions we perhaps should take to provide some kind of a permanent central reserve of a reasonable size, which we could accumulate over many years. This could be done within the Farm Credit Administration, perhaps.

Do you have any comments on that topic?

Mr. SETHNESS. Congressman Evans, this is a new concept. But to give you a quick reaction to it, it would seem to me to make a good deal more sense for the system to do what it has been doing over the last 50 years, which is, as circumstances permit, having each individual institution and bank build a reasonable amount of earned surplus and that 20 or 30 years from now, if we get into another situation like we are today, there will be a structure in place so that that surplus, too, can be distributed to those that most need it. And there will be a tremendous incentive in the meantime for all of the institutions in the system to keep an eye on their brethren, who they know in advance they are going to be standing behind. There will be real, positive, local financial incentives for not having other people engaging in unsafe and unsound banking practices.

Mr. EVANS of Iowa. You understand, however, that, if you depend on accumulated earnings in individual institutions, and those institutions realize that those can be assessable in the future, there is going to be a great reluctance on the part of those institutions to accumulate surpluses, as opposed to some system wherein they might check off one-tenth of 1 percent on each new bond issue and it go directly.

Would you comment on that?

Mr. SETHNESS. Well, there is no question that there would be resistance. And it's not any surprise to anybody here that there is some resistance to the plan in this bill from certain system institutions. That is one of the reasons why we want to be sure that the FCA has effective and strong regulatory powers to set capital standards for individual institutions in the same way that other financial regulators have to get institutions to maintain appropriate levels of capital.

Mr. EVANS of Iowa. We are out of time, unfortunately.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Evans, for your questioning.

The Chair now recognizes Mr. Stenholm for 5 minutes.

Mr. STENHOLM. Thank you, Mr. Chairman.

Administration witnesses today and previously before the Banking Committee on November 13 seem to be implying that all that is necessary to solve the problems of the Farm Credit System is a redistribution of the assets or the reserves of the system banks. You seem to be implying that. I say seem to. Mr. Sethness, when you say the system does not now need the Government's financial support in any fashion, I take it that you are implying that that is your conclusion.

My question to you is, do you, as a result of coming to this emphatic conclusion, do you see any danger, or have you found any danger that redistributing resources from strong banks to weaker banks could have a serious and adverse impact on farm borrowers in economically healthy farm regions today?

Mr. SETHNESS. Congressman Stenholm, there may be some, what I believe will be relatively modest, increase in interest rates to borrowers in the strong districts as a result of spreading out the system's resources and its problems. I think it is also true that there is a strong possibility that there will be a decrease in interest rates available from the Farm Credit System institutions in the more severely distressed areas.

Mr. STENHOLM. So, you think——

Mr. SETHNESS. I think it's also fair to say to your prefatory statement that the conclusion that no financial assistance is necessary and will not be over a 24-month period is based on a number of assumptions which might not work out that way.

Mr. STENHOLM. That's encouraging.

By your previous statement then, you do acknowledge that there is going to be some increased interest cost in some areas, some decreased interest cost obviously in other areas if the theory works?

Mr. SETHNESS. This is looking at it as an outsider—whatever you want to call me—a financial technician. I don't know what the real, local, operational impacts are going to be.

Mr. STENHOLM. Has the Treasury made a careful study that, if this pooling occurs, which can and is going to occur to some degree—no question about that—what the impact of increased interest rate expense on farm borrowers and the potentially increased failure rate of donating farm credit entities under this procedure?

Mr. SETHNESS. Our study would indicate to us that for some very significant period of time nobody needs to fail in the system, that there is adequate earned surplus there to avoid that result. So, I guess I can say that, yes, we have conducted a study on the likelihood of increased failures of system institutions and concluded that that's unlikely to happen.

Mr. STENHOLM. Most studies that I have seen coming from the administration, and everyone else, confirm that farm income is declining, no question about that. You have this year—the administration now have this year—supported changes in farm programs that would decrease farm income dramatically in the short run, requested, for example, only this week we're continuing to fight the battle of a required abrupt drop in dairy price supports, for example.

How does this analysis of what you have just told me, how does that square with what the Department of Agriculture is recommending as far as current policy?

Mr. NAYLOR. Mr. Stenholm, in looking at this as an institutional question, the Treasury and ourselves and, I believe the system, use the USDA economic models. They anticipate, in a broad, macroeconomic sense, a continued decline in the range of 10 to 20 percent in land values, in some specific instances more than that. They anticipate some decline in farm income under any projection of farm legislation over the next 2 years. These projections were factored into our assessment of the prospective effect of actions to stabilize the Farm Credit System.

Mr. STENHOLM. Mr. Sethness, I am troubled, though—my time has expired. I will come back on the next round.

Mr. JONES of Tennessee. Thank you very much, Mr. Stenholm.

Now the Chair recognizes Mr. Franklin for 5 minutes.

Mr. FRANKLIN. Thank you, Mr. Chairman.

I would like to address these questions to, first of all, the system. In your statement you indicate that there is available $5.5 billion in loan loss reserves and $1.6 billion—$1.6 billion in loan loss reserves and earned surplus of $5.5 and in stock of $5.3. Under the provisions of this bill, we have to eliminate the stock because you are going to be forbidden from pooling that, as I understand it.

Do you know where those assets are? Is there a list somewhere that we can look at to see where those assets of the system actually are and what form of the securities are they in?

Mr. SWACKHAMER. The answer is yes, there is. They exist in the institutions of the system. That's all of the PCA's, the land bank associations, and the 37 banks. And that can be made available.

Mr. FRANKLIN. Could I have a copy of where those assets actually are and what the form of the asset is?

Mr. SWACKHAMER. Yes, sir.

[The information follows:]

THE FARM CREDIT COUNCIL
1800 MASSACHUSETTS AVE, NW · WASHINGTON, DC 20036 · 202/466-4180

November 22, 1985

Congressman Ed Jones
Chairman
Subcommittee on Conservation,
  Credit, and Rural Development
House Agriculture Committee
Longworth House Office Building
Room 1301
Washington, DC 20515

Dear Mr. Chairman:

Thank you for your co-sponsorship of H.R.3792 and the prompt action taken to hold hearings on November 21 and schedule mark up for Tuesday, December 3, 1985.

The Farm Credit Council stands ready to respond to any inquiry you, your Committee or its staff might have regarding this bill and its effects as further consideration is given to this matter. We share your sense of urgency and desire for prompt Congressional action.

In response to a question of Congressman Franklin during the hearing for information on the location of FCS capital, I am pleased to present the attached tables, explanation and analysis. I hope you will share this information with your Committee if you feel it is appropriate to do so.

Farm Credit System capital is of two types - that which is borrower/stockholder owned and identified and that which has been accumulated by the Banks and Associations as surplus (unallocated to borrowers and unappropriated both of which are called earned net worth). Both forms constitute risk funds as do the loan loss reserves.

In the consideration of capital available for assistance to needy banks or associations, borrower identified ownership is protected as it should be in H.R.3792, Sec.4.28H.(14)(A). Loan loss reserves are non-transferable to the extent that they already exist to protect the individual Banks and Associations against identified potential losses in the loan portfolio. They can be utilized through loss sharing agreements and the purchase of loss loans from other institutions upon which immediate charge-offs are taken, thus reducing the loan loss reserve. Surplus is the remaining category of risk funds available to provide financial assistance to other institutions of the Farm Credit System under Sec. 4.28H.(14)(A) to the "extent practicable, and consistent with sound business practices."

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The surplus of FCS institutions is committed to support joint and several liability through the banks under Sec. 4.4 of the 1971 Farm Credit Act. As suggested by Mr. Franklin and other Congressmen during the hearings, the practicality of mobilizing surplus from many corporations is not a simple matter. Surplus is employed in each business to support loans, liquidity investments and other assets, thus each institution responding to an assessment or call for investment in the Capital Corporation would do so by issuing more debt. Then, by increasing costs (assessments are expensed and interest on debt is expenses) and by reducing income (stock in the Capital Corporation becomes a non-earning asset) surplus is depleted unless interest rates to borrowers rise by an offsetting amount.

Also attached with this letter is "Analysis of the Effect of Depletion of Farm Credit System Surplus" which further explains the consequences to borrowers of depleting FCS surplus. It is based upon this knowledge that clarifying language regarding capital consolidation is essential for farmers. Depletion of all surplus removes the buffer against stock impairment, creates a federal financial assistance dependency and is not a prudent business act.

Mr. Chairman, we recognize that these are complex financial and accounting terms and we are trying to simplify them as much as possible.

Sincerely yours,

Gene L. Swackhamer

Gene L. Swackhamer

cc: Rep. Webb Franklin

Attachments

Farm Credit System
Analysis of Risk Capital
As of 9/30/85
(in millions of dollars)

	Stockholder Ownership			Surplus				
	Capital Stock	Participation Certificates	Allocated Surplus	Appropriated /Unallocated	Unappropriated	Total Capital	Loan Loss Reserves	Total Risk Capital
SPRINGFIELD:								
FLB	*	*		62.1	0.8	62.9	14.7	77.6
FICB	*	0.1	*	5.0		5.1		5.1
BC	38.1		9.1	5.9		53.1	2.0	55.1
FLBAs	53.8	6.3		2.6	15.8	78.5		78.5
PCAs	56.6	0.7		59.0		116.3	23.0	139.3
Total	148.5	7.1	9.1	134.6	16.6	315.9	39.7	355.6
BALTIMORE:								
FLB	*	*		76.7	75.9	152.6	20.0	172.6
FICB	*	3.6	1.0	8.5		13.1	0.8	13.9
BC	13.3		0.2	5.0		18.5	1.9	20.4
FLBAs	104.5	14.1		5.6	38.7	162.9	22.3	185.2
PCAs	56.4	1.0		90.7		148.1	25.0	173.1
Total	174.2	18.7	1.2	186.5	114.6	495.2	70.0	565.2
COLUMBIA:								
FLB	*	*		216.9	199.4	416.3	53.5	469.8
FICB	*	0.2	0.1	16.3		16.6	6.0	22.6
BC	43.4		8.8	8.8		61.0	4.9	65.9
FLBAs	249.3	39.4		4.9	31.6	325.2	20.1	345.3
PCAs	167.6	9.0	0.4	211.7		388.7	35.8	424.5
Total	460.3	48.6	9.3	458.6	231.0	1,207.8	120.3	1,328.1
LOUISVILLE:								
FLB	*	*		134.7	20.7	155.4	48.3	203.7
FICB	*	0.6	0.3	10.7		11.6	11.9	23.5
BC	68.3		22.6	10.2		101.1	7.7	108.8
FLBAs	235.7	9.0		7.5	17.7	269.9	12.4	282.3
PCAs	149.6	1.0	0.9	234.8		386.3	31.7	418.0
Total	453.6	10.6	23.8	397.9	38.4	924.3	112.0	1,036.3

* -- Item was eliminated in combination.

Farm Credit System
Analysis of Risk Capital
As of 9/30/85
(in millions of dollars)

	Stockholder Ownership			Surplus				
	Capital Stock	Participation Certificates	Allocated Surplus	Appropriated /Unallocated	Unappropriated	Total Capital	Loan Loss Reserves	Total Risk Capital
JACKSON:								
FLB	*	*		77.8	39.3	117.1	72.5	189.6
FICB	*	9.4	1.6	8.8		19.8	3.5	23.3
BC	95.0		19.7	6.6		121.3	4.8	126.1
FLBAs	135.5	13.7		6.3	4.3	159.8		159.8
PCAs	79.6	0.5		73.4		153.5	8.0	161.5
Total	310.1	23.6	21.3	172.9	43.6	571.5	88.8	660.3
ST. LOUIS:								
FLB	*	*		160.9	95.5	256.4	82.5	338.9
FICB	*	1.7	0.5	9.1		11.3	3.4	14.7
BC	65.8		16.7	11.5		94.0	10.1	104.1
FLBAs	263.8	5.4		5.3	24.2	298.7		298.7
PCAs	121.7	0.4	4.6	160.8		287.5	31.7	319.2
Total	451.3	7.5	21.8	347.6	119.7	947.9	127.7	1,075.6
ST. PAUL:								
FLB	*	*		291.6	209.1	500.7	150.8	651.5
FICB	*	11.1	3.4	8.9		23.4	3.9	27.3
BC	171.4		50.7	11.3		233.4	18.7	252.1
FLBAs	359.6	20.9		9.6	58.8	448.9	13.4	462.3
PCAs	277.7	2.6		328.0		608.3	49.5	657.8
Total	808.7	34.6	54.1	649.4	267.9	1,814.7	236.3	2,051.0
OMAHA:								
FLB	*	*		161.0		161.0	187.7	348.7
FICB	*	7.8	2.3	(38.6)		(28.5)	2.6	(25.9)
BC	72.8		13.9	6.1		92.8	5.5	98.3
FLBAs	286.5	8.0		9.0	20.0	323.5		323.5
PCAs	154.8	0.9		125.9		281.6	21.4	303.0
Total	514.1	16.7	16.2	263.4	20.0	830.4	217.2	1,047.6

* -- Item was eliminated in combination.

Farm Credit System
Analysis of Risk Capital
As of 9/30/85
(in millions of dollars)

	Stockholder Ownership			Surplus				
	Capital Stock	Participation Certificates	Allocated Surplus	Appropriated /Unallocated	Unappropriated	Total Capital	Loan Loss Reserves	Total Risk Capital
WICHITA:								
FLB	*	*		197.2	74.6	271.8	151.1	422.9
FICB	*	11.7	2.8	4.3		18.8	11.1	29.9
BC	107.6		23.6	23.6		154.8	4.7	159.5
FLBAs	259.7	12.6		5.6	37.2	315.1		315.1
PCAs	86.4	1.1	0.5	170.7		258.7	32.3	291.0
Total	453.7	25.4	26.9	401.4	111.8	1,019.2	199.2	1,218.4
TEXAS:								
FLB	*	*		74.8	77.5	152.3	43.4	195.7
FICB	*	13.8	3.1	30.1		47.0	1.4	48.4
BC	26.9		4.4	14.7		46.0	2.2	48.2
FLBAs	141.8	11.0		29.4	63.1	245.3	13.3	258.6
PCAs	113.5	1.7	0.5	131.8		247.5	41.2	288.7
Total	282.2	26.5	8.0	280.8	140.6	738.1	101.5	839.6
SACRAMENTO:								
FLB	*	*		113.1	104.9	218.0	53.1	271.1
FICB	*	4.7	1.8	9.9		16.4	1.2	17.6
BC	91.0		21.2	12.6		124.8	15.6	140.4
FLBAs	258.9	2.0		6.5	36.1	303.5		303.5
PCAs	268.9	10.5		176.8		456.2	58.2	514.4
Total	618.8	17.2	23.0	318.9	141.0	1,118.9	128.1	1,247.0
SPOKANE:								
FLB	*	*		114.5	109.5	224.0	38.1	262.1
FICB	*	4.1	0.9	9.1		14.1	5.3	19.4
BC	39.8		7.9	5.1		52.8	5.0	57.8
FLBAs	190.6	5.8		6.9	44.8	248.1	18.0	266.1
PCAs	77.2	0.2	2.1	82.0		161.5	20.6	182.1
Total	307.6	10.1	10.9	217.6	154.3	700.5	87.0	787.5

* -- Item was eliminated in combination.

Farm Credit System
Analysis of Risk Capital
As of 9/30/85
(in millions of dollars)

	Stockholder Ownership			Surplus				
	Capital Stock	Participation Certificates	Allocated Surplus	Appropriated /Unallocated	Unappropriated	Total Capital	Loan Loss Reserves	Total Risk Capital
CBC:								
BC	*			59.2		59.2	39.0	98.2
Total	0.0	0.0	0.0	59.2	0.0	59.2	39.0	98.2
SYSTEM GRAND TOTALS:	4,983.1	246.6	225.6	3,888.8	1,399.5	10,743.6	1,566.8	12,310.4

* -- Item was eliminated in combination.

Analysis of the Effect of Depletion of Farm Credit System Surplus

The proposal to consolidate the surplus of all Farm Credit System institutions by assessing each corporation or requiring its purchase of stock in the Farm Credit System Capital Corporation on the surface appears to resolve the immediate need for Federal financial assistance. Unfortunately, financial problems arising from agricultural loan losses and other non-accrual loans are not so easily solved.

The Administration has argued that the FCS has no need for Federal financial assistance because it has over $5 billion of surplus in the aggregate to cover losses and buffer stock. Aside from the enormous legal and economic complexities of consolidating the surplus of 700 corporations, the argument is further made that the surplus can be depleted without cost to farmers since banks and associations can report operating losses and continue to successfully fund themselves with Treasury assurances to the market.

The argument that surplus can be depleted without cost to borrowers is invalid. Surplus, as earned net worth, is now employed in the operations of each business as loans, investment and other assets. As the income from debt-free earned net worth is lost, it must ultimately be replaced by borrowed funds with an interest cost. The table below shows the impact of interest cost as surplus is depleted.

Surplus as a % of Assets	Amount of Surplus Remaining (millions)	Surplus Depleted	Interest Impact of Surplus Depletion* (Basis points)	Interest Impact to Restore Surplus* (Basis points)
1%	$ 750	$ 4,250	64**	128
2	1,500	3,500	52	104
3	2,250	2,750	41	82
4	3,000	2,000	30	60

*Calculated at 10 percent average cost of debt.

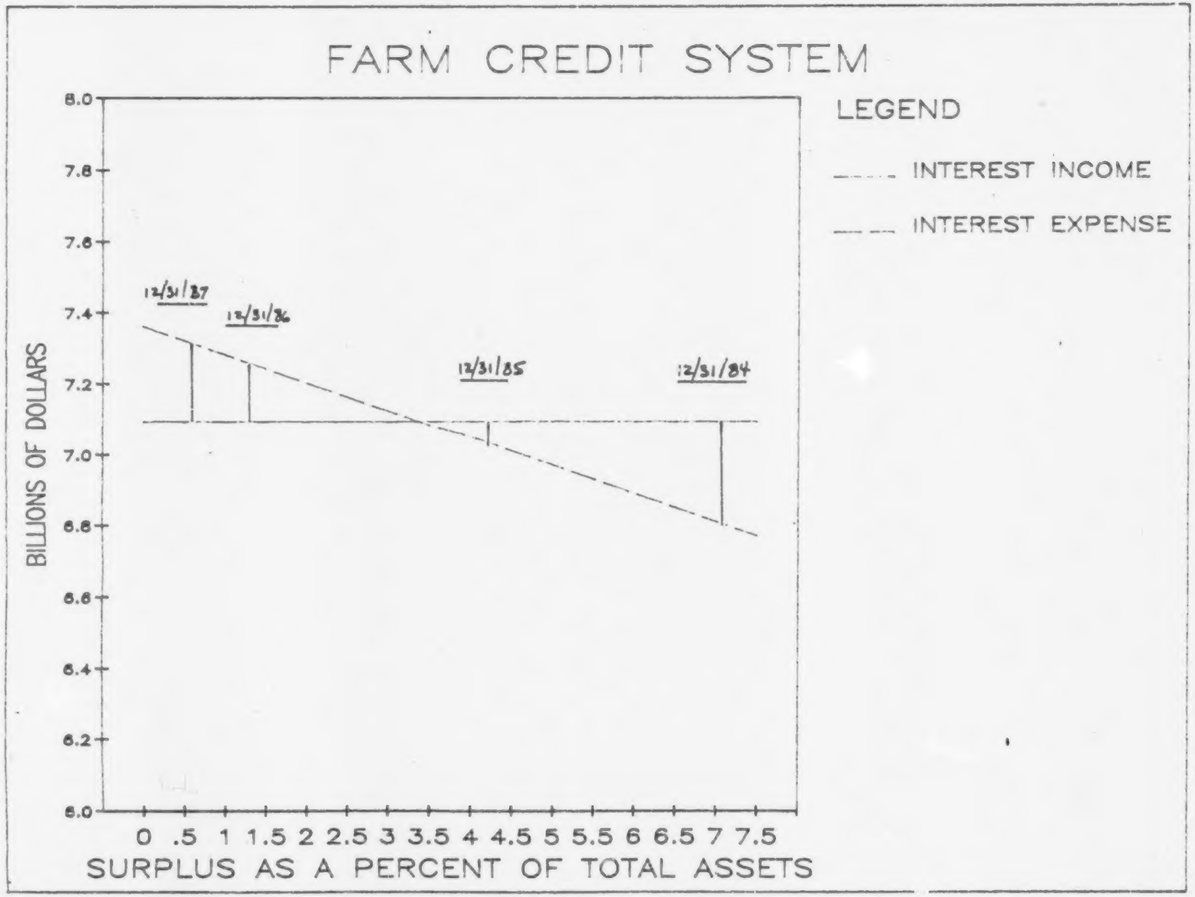
**For example, $4,250 million of surplus times 10 percent divided by $66 billion of interest bearing assets equals 64 basis points of interest cost per year.

Shown another way, the graph of interest income and cost of debt illustrates the effect of surplus depletion. From a strong financial position at December 31, 1984, the FCS will be in an adverse earning position on December 31, 1985, even with surplus representing 4.2 percent of interest earning assets. The request for Federal financial assistance is to supplement this deficiency in carrying non-accrual assets to avoid further surplus depletion and ultimate adverse interest impact on borrowers.

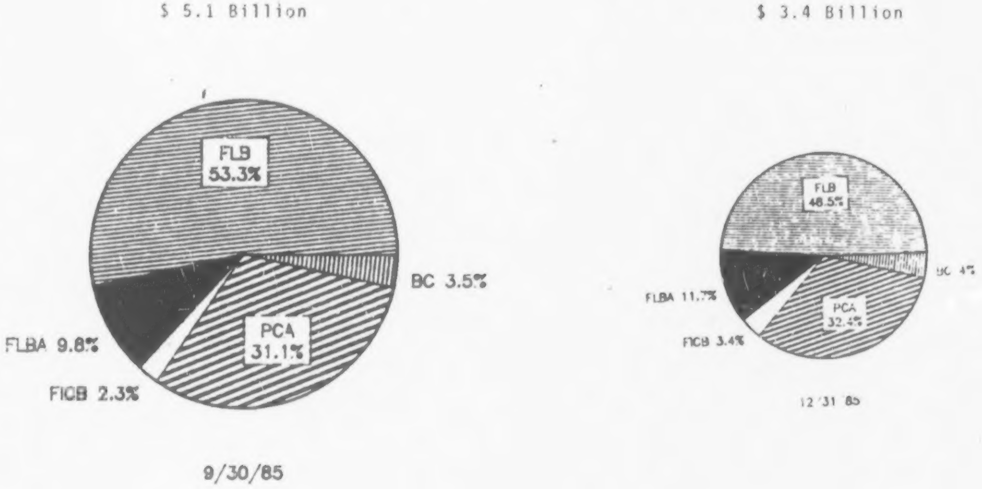
Farmer-borrowers as owners of FCS institutions will pay these costs in higher interest rates for loans. Only the timing and speed of recovery are in question. The fact that recovery is necessary lies in:

1. The need for repayment of Federal financial assistance which is dependent upon future earnings. Future earnings cannot be realized from interest spread over borrowing cost alone. A level of earned net worth must be rebuilt to keep interest costs to borrowers reasonable;
2. Restoration of a buffer of earned net worth above borrower stock is essential to avoid the ever present risk of impairment and to provide for future adversity in a cyclical industry; and
3. Absent any evidence of rebuilding of earnings, both investors and stockholders will doubt the safety and soundness of the Farm Credit System even with government assistance.

In summary, there is no free lunch. Surplus cannot be depleted without a cost to farmer-borrowers. The cost may be deferred to a future generation of borrowers, but it is inevitable.


FARM CREDIT SYSTEM
LEGEND
INTEREST INCOME
INTEREST EXPENSE
BILLIONS OF DOLLARS
8.0
7.8
7.6
7.4
7.2
7.0
6.8
6.6
6.4
6.2
6.0
12/31/87
12/31/86
12/31/85
12/31/84
0 .5 1 1.5 2 2.5 3 3.5 4 4.5 5 5.5 6 6.5 7 7.5
SURPLUS AS A PERCENT OF TOTAL ASSETS

FARM CREDIT SYSTEM SURPLUS



Mr. FRANKLIN. Do you know how many of those assets that you are counting have been plowed back into the system as far as farmer loans, additional loans that have been made out there?

Mr. SWACKHAMER. Well, the——

Mr. FRANKLIN. As opposed to CD's or some——

Mr. SWACKHAMER. Yes.

The net worth side of our institutional balance sheet shows reserves. The reserves are there in the form of loss reserves to deal with specific types of potential losses or actual losses. And when they are taken, it becomes a chargeoff and disappears. The surplus is divided into earned surplus and the other that it is allocated to borrowers. All of that is employed in the operation of the business to support the assets, meaning investments, loans, buildings, and other parts of the business.

The stock is the borrower-owned stock of the business. It is not really transferrable because it's there to support the borrower's loan; and we can't really move it. So, we are only talking about the employment of reserves which can be moved by the purchase of a loss loan from some other part of the country or the earned net worth part of surplus which can be moved to the Capital Corporation by——

Mr. FRANKLIN. How much of those assets that you're claiming here are liquid, that you can move today?

Mr. SWACKHAMER. Well, they are not liquid in the sense that they are currently employed. Our approach would be to borrow money for whatever the amount of the assessment would be and through time, as losses are realized, you deplete the earned net worth.

Mr. SIMS. Let me address that just a little bit further, Mr. Franklin. All of this net worth, which includes the surplus reserves, is invested in the assets on our balance sheet, which are loans. And there are about—there are liquidity requirements that we have to have investments in order to meet our bond obligations each day or month. So, if you want to look at where that money is invested, you look at the left-hand side of the balance sheet. And it's both in loans, investments, buildings. It's all up and down the balance sheet.

There isn't a cash drawer someplace with that money in it. In order to write those checks, you have to borrow the money to write the checks to the Capital Corporation I think that's what you're getting at, sir, is that right?

Mr. FRANKLIN. That's exactly what I am getting at.

Mr. Sethness, you seem eager to address this question.

Mr. SETHNESS. I was just going to comment that there is 5.5 billion dollars' worth of liquid assets on that left-hand side of the balance sheet. But you can't attach it 1 to 1 with any entry on the right-hand side.

Mr. FRANKLIN. All right now, the second kicker in the bill, as I understand it, as far as restrictions from pooling these assets, is that you can't take an individual institution and remove the assets that it has in earned surplus or whatever to the point where it will not be viable as far as the interest rates it can charge its individual borrowers.

Has anyone made an analysis of how much actual cash money can then, under the restrictions of this bill, flow into the Capital Corporation to fund it?

Under the restrictions, you can't take away the earned surplus or the reserves of an independent institution and make it not viable as far as the interest rates it is able to charge its borrowers on a competitive rate in the locality. How much is that—in other words, how much money is there going to be to fund the Capital Corporation without an infusion of capital from the Government?

Mr. SETHNESS. It's not an immediate cash question, Mr. Franklin. The 5.5 billion dollars' worth of surplus is out there on the right-hand sides of a lot of balance sheets. The entities are borrowing and lending on a continuing basis. They have the ability to continue to borrow and lend. If one of the daily activities that they do one day is to write a check to the Capital Corporation which decreases the cash on the left-hand side of the balance sheet and decreases the earned surplus on the other side of the balance sheet, they will probably have to borrow some money to cover that in the interim until or unless some of their loans pay down or they have investments to liquidate to cover that check they wrote.

Mr. FRANKLIN. Would this not affect interest and drive it upward?

Mr. SETHNESS. As I believe I said before to Mr. Stenholm, there is some possibility that there would be an increase in interest rates from some base at the local institution level. But I would like to add that, if we get done what we think is important for the system and the FCA to get done, the total cost of borrowing of the whole system and interest rates to all borrowers from the system ought to come down as the markets get reassured that they don't have to continue to charge 80 basis point spreads.

I should note that 80 basis points is better than it has been, and spreads have been tightening up somewhat.

Mr. FRANKLIN. Bottomline question. Under the restrictions that are contained in this bill about how the assets can be pooled, how much money can the Capital Corporation be funded with from within the system?

Mr. SETHNESS. Our belief is that over time it can be funded——

Mr. FRANKLIN. Today, I mean once we pass the bill, how much assets are going to be out there to fund the Capital Corporation without an infusion of capital from the Government?

Mr. SETHNESS. Enough.

Mr. COLEMAN. Would the gentleman yield?

Mr. FRANKLIN. I would be happy to yield.

Mr. COLEMAN. This is the same type of questioning that I made of these gentlemen. And their response to me at that time was that in fact no cash drawer, as Mr. Sims said, is available at these banks, they would in effect be taking on additional obligations in the bond market and end up transferring that to the Capital Corporation. And their responsibilities would be increased by that much.

Is that what you responded to me in a similar line of questioning?

Mr. SIMS. That is correct, that the additional obligations would cost us more, and it would result in one of two things: either increased losses, in other words, on the operating statement; or higher interest rates. Now, you could put off that interest rate impact as you draw down that surplus. But at some point in the future that would have to be rebuilt.

Mr. **Franklin**. Mr. Chairman, I see that I am out of time. I would like to explore the subject further, but I will yield back.

Mr. **Jones** of Tennessee. Thank you very much, Mr. Franklin.

The Chair now recognizes Mr. Thomas for 5 minutes of questioning.

Mr. **Thomas**. Thank you, Mr. Chairman.

I would like to address my question to the gentlemen from the Farm Credit Administration who are here with us today.

I guess, when you look back, it would be very easy to say that the system of and the approach of farmer directors running the system and making it work and making the decisions has not worked to some degree because of the conditions and the time in which we have arrived. I think it's the admission of a considerable amount of failure when we do this.

My question out of this comes in the differences we have as the way we would come up with the board and those who would control the new Capital Corporation. I would like a straight-out answer from FCA as to really what is it you are asking us for. Do you want to regulate the system? Or do you literally want to run it? Do you want to take the control out of the kinds of traditional hands in which it has rested? Is that the intent or not?

Mr. **Wilkinson**. Mr. Thomas, the Farm Credit Administration has indicated time and time again at various hearings that it has a very strong desire to remove itself from the management of the private Farm Credit System. Your question deals specifically with an extremely unique entity that I have already said will be within the Farm Credit System, and I refer to the Capital Corporation.

One of our concerns is that the job of this Capital Corporation is going to be an extremely difficult one. We have been talking about parts of it at this particular time. We have, as we have been in this period of stress, been aware of the fact that the system has good intentions but has extremely difficult times in providing assistance to other parts of its own institution. It takes a great amount of time to do it.

We also are greatly concerned that there may be a break point within the system as to how long that will continue. It is therefore our recommendation that this Capital Corporation, a unique institution of the system, have a board of directors that is accountable to the regulatory agency, which is accountable to you. This is not unlike some of the other financial assistance programs which the Treasury and the administration have been dealing with. They named the board of Chrysler. They named the board of some of the other institutions. We are proposing the same here.

Mr. **Thomas**. Let me put it a little bit differently to you, and let me ask you this question. Then you would say to me that it is not the intent of FCA to create here an instrument through which we can more rapidly get about the business of foreclosing and putting farmers out of business, and that you would say that you certainly are not doing this and that you would not agree that—and my feeling, to some degree—that you don't feel that the current system of farmer directors can carry that out fast enough?

Mr. **Wilkinson**. Our No. 1 concern is that farmers benefit by the preservation of their own unique mechanism to bring them credit. That's the preservation of the Farm Credit System for the farmer's benefit.

What we want to do is to attempt to allow the system institutions to provide credit to those farmers who are creditworthy, to utilize this new institution to provide expertise in restructuring of loans, working out of loans. And yes, there are going to be times when there will be liquidation of those loans, sir.

Mr. **Thomas**. Well, I am still very fearful that there are a lot of people in a lot of places, both in the administration and in both of these houses of the Congress, right here in this room today, that absolutely feel that the only cure for the problem in this country's agricultural illness is that we are going to have to go through this unprecedented decimation in the number of farmers in our country before we are going to get well.

To give you a few facts, on my own State of Georgia, I want you to see how severe it's going to be. Now listen to this. This comes from the Administrator of the Farmers Home Administration in Georgia: The State of Georgia, caseload and delinquent, 8,331 active borrowings; number delinquent, 4,543, or 54 percent.

Let me go ahead and just show you just how severe it is: 179 of those borrowers owe $332 million, with $121,450,000 being delinquent.

Now, this is where we sometimes hear these statements about only 1 or 2 percent of our farmers being in trouble. But what this indicates is that 2 percent of FmHA borrowers owe about 28 percent of the total debt and represent 17 percent of the total.

My point to you is that the stage is set—if I might continue my statement; I see I am out of time. The stage is set in my own State, for example, where, if the Federal Land Bank and Farmers Home Administration through the opening up of the gates begin this process, what we are doing here in this room today is not going to amount to a hill of beans if we pass this provision exactly as you would like to see it done, because we'll all be sitting right back here.

This is just my fear, that what we're all doing is just simply saying we cannot stop what's going to happen; we simply want to set up some institutions to facilitate the easy flow of this flood.

I, for one, have serious concern that that is what we are trying to do in arranging the control of this new Capital Corporation.

Thank you, Mr. Chairman.

Mr. **Jones** of Tennessee. Thank you very much, Mr. Thomas.

I wish I could recognize the members of the full committee, but I think for the sake of the authors of this bill that we should confine our work to the subcommittee this morning and with more questioning. But before I do that, I want to recognize Chairman de la Garza for any statement that he might want to make.

The **Chairman**. Thank you, Mr. Chairman.

Very briefly, I want to thank all of the witnesses this morning for their contribution.

Mr. Sethness, I have a couple of questions or clarifications. I appreciate your recommendations. By and large, I think they are constructive. I certainly feel that we could work.

My one question relates to giving the new Capital Corporation borrowing authority. You state that this shouldn't be blanket authority, that they should be authorized to raise funds through systemwide debt issues. Would you explain the procedure that you would use to do that?

Mr. SETHNESS. The system currently borrows its funds through consolidated obligations of the 37 banks for which the 37 institutions are jointly and severably liable. We think that that is the way that the Farm Credit System Capital Corporation should also raise its funds.

The CHAIRMAN. So, what you are suggesting is then that the corporation notify——

Mr. SETHNESS. No, that it become a joint and severable obligor on those system bonds. The legislation provides for that already, but——

The CHAIRMAN. Well, you have some question as to whether they're joint and severable——

Mr. SETHNESS. Well, there's a—what we hope can be solved by adding a C after section 4.3——

The CHAIRMAN. But you would make it just another bank and continue the systemwide issuing of paper, and you add an additional amount for what they would say would be their need or——

Mr. SETHNESS. Or they would have the ability to assume obligations of other banks under those consolidated obligations as they transfer assets and liabilities between them.

The CHAIRMAN. You have no problem with that?

Mr. SETHNESS. No.

The CHAIRMAN. Because if they assume them for repayment they would go outside of the system. At any rate, they would be dealing outside of the system in some areas.

Mr. SETHNESS. I don't believe that they need to do so.

The CHAIRMAN. If you transfer an obligation from the system to ex parte to them——

Mr. SETHNESS. No, but they're not ex parte; they are internal to the system.

The CHAIRMAN. No, no, but the obligation is to Party X. They get the obligation.

Mr. SETHNESS. Oh, the obligation we're talking about is in existence in the market already, it's a consolidated systemwide obligation. The only liabilities that I was talking about transferring would be between one of the land banks and the Capital Corporation——

The CHAIRMAN. What you're saying is that they shouldn't issue their own paper?

Mr. SETHNESS. Yes.

The CHAIRMAN. Working within the system.

The other question I have is on the merger situation. You suggest that—in your statement, I quote toward the bottom of page 9: This change would make a districtwide association merger possible where the vast majority of associations or shareholders seek it.

Do you mean that a district would be merged into one entity?

Mr. SETHNESS. If the shareholders in that district of like associations agreed, they could have such a merger.

The CHAIRMAN. You would limit it to like associations?

Mr. SETHNESS. Yes.

The CHAIRMAN. I hadn't seen the like. I wondered if you could roll in——

Mr. SETHNESS. The like associations is in——

The CHAIRMAN. The FCA and the land bank and——

Mr. SETHNESS. No, no, the "like associations" is in the second line of that paragraph.

The CHAIRMAN. Yes, I had missed that.

But you leave the authority solely again with the stockholders of the different organizations whether they merge or not, like associations.

The other question I had was on your nine: New Enforcement Power. Are you saying that we did a good job but somehow we should leave the language as it is now, or not clarify or——

Mr. SETHNESS. No. There were several pieces of drafting assistance available for people to work on. The model that was adopted for the bill as it exists was an attempt to clarify and simplify what is very complicated language that exists for other financial institution regulators.

The CHAIRMAN. So, you say——

Mr. SETHNESS. What we're——

The CHAIRMAN. Simplify and clarify——

Mr. SETHNESS. I think that we——

The CHAIRMAN. Leave it like it is?

Mr. SETHNESS. Leave it like it is. Not in the bill. Leave it like it is for the other regulators because of the real risk that we would be opening up a flood of litigation to challenge what this language means for FCA as compared with the FDIC. Why is it different? It could be the Lawyers' Full Employment Act of 1985.

The CHAIRMAN. My time has run out.

I don't know that I agree with you, because FDIC has it—you couldn't go to court saying the new Farm Credit Administration is not exactly written like the FDIC——

Mr. SETHNESS. No, you would go to court to challenge how that regulation and that enforcement power should work. There is already a large body of case law developed for the existing authorities that other regulators have, so you don't have to start all of the questioning in court as to whether they can do that or can't do that all over again with new language.

The CHAIRMAN. That must be a new law, because I don't know that you could sue to go and ask a court to define how a regulation should work.

Mr. SETHNESS. No, you would sue in the event that FCA tried to take an enforcement action under its authorities with this new language.

The CHAIRMAN. Then you would challenge the action.

Mr. SETHNESS. Then you would challenge the action, and over x number of years you would develop a body of case law that already exists if you use existing language.

The CHAIRMAN. Thank you very much.

Thank you very much, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Chairman de la Garza.

Now the Chair recognizes Mr. Morrison for 5 minutes of questioning.

Mr. MORRISON. Thank you, Mr. Chairman.

I would like to explore for the time that I have the question of investor confidence. I guess, Mr. Sethness, we're picking on you this morning because you're fresh meat for this subcommittee.

Mr. SETHNESS. If I may be permitted, Mr. Morrison, I thought I was coming to Washington to manage the debt and things like that. It's a surprise and a pleasure to me to be in front of this subcommittee, I must say.

Mr. MORRISON. Somehow, all we're doing is giving you new debt to manage, Mr. Sethness, so this really won't be that much of a shift.

I have understood in discussions, I think, with everyone at the table that a most important element of the farm credit problem in these next few months, particularly in view of the significant rollover that needs to occur on some paper that needs to change hands in the next few months, that investor confidence is going to be most significant. I would like to ask you if you would comment on the three parts of the bill as viewed from an investment point of view.

The bottom line I am seeking, I guess, is to say, you know, because of the reorganization, does the sharing of existing assets, will that build confidence in the mind of investors out there to the point that we will continue to have a fairly reasonable market for Farm Credit System paper?

Mr. SETHNESS. Well, it is my belief that, if the first two parts of the bill get passed and there is a continued willingness and interest on the part of the administration to assess the system's need for Federal financial assistance, that there will in fact be a reasonable market for Farm Credit System paper. This would be a considerable reassurance to investors for several reasons: one, in a relatively short timeframe in an extremely complicated situation, bipartisan effort has been pulled together to get anything done in a highly contentious area; two, that what we are looking at getting done is a very positive and constructive set of reforms and restructuring that should make it much more possible for the system to deal with its own problems; and three, I think the debt market is coming to an increased awareness of what the system's capacities are to withstand the problems that they've got.

Mr. MORRISON. What happens with the introduction of this particular bill, which includes an element of a discretionary program for some backup financing, if in fact that is not included in the package? Does that send a signal to investors that Congress and the Government really are not serious in backing up this system?

Mr. SETHNESS. I would hope that they would not read it that way. I would not expect that they would read it as an abandonment of the system.

Before you ask the next question, I think there is no question that the market would be dramatically more reassured if there were a backstop in it. I don't think that is at issue.

Mr. MORRISON. I appreciate your anticipating that, because that was the question. If this package is passed, I personally think that we delay the day when you have to invoke part No. 3, which is an infusion of financing, because the confidence that it builds just by having it in legislative form, I believe, will have a significant signal that will be much more easily read by investors than will be a reorganization of the system.

So, I would hope that when we get down to the point that this committee passes this bill and it goes on through the Congress, that you will take into consideration that we really do want to send a signal and a positive signal; and that signal, I think, perhaps reduces your need to ever use the discretionary authority that it might give you.

Thank you, Mr. Chairman. I appreciate the opportunity to ask that question.

Mr. JONES of Tennessee. Thank you very much, Sid.

Now that completes the first round of the subcommittee questioning. The Chair now recognizes Mr. Coleman for any additional questions.

Mr. COLEMAN. I would like to pursue the line that Mr. Franklin was pursuing, because I don't think he was satisfied, nor do I think the record is satisfied.

Mr. Sethness, maybe I will start with you, because you didn't get a chance to answer the last time. Walk us through how you would foresee a marshaling of funds from one institution to another under the Capital Corporation as drafted here in this bill.

Mr. SETHNESS. I would like to give a couple of caveats, that I think you understand, that I am neither from the system operating management nor am I an accountant. With those caveats, I think that what one would be looking at would be either an asset or a liability transfer between two entities: one which had earned surplus, and another which was about to run out of it. That transfer could be accomplished by sending cash, if the institution had it. It could be accomplished by reducing liquid asset holdings of the sending institution, if it had liquid assets that it could sell down and produce cash to send it. It could also be done by increasing the borrowing of the sending institution and decreasing the borrowing of the receiving institution. Whether that gets done in an accounting sense as a direct swap of obligations, I don't know.

Mr. COLEMAN. The Capital Corporation is to serve as a reservoir for all this activity and not necessarily go from one institution, one bank to another bank. Is that correct? You meant to go through the Capital Corporation?

Mr. SETHNESS. Each of those transactions could go through the Capital Corporation. I was trying to get it as——

Mr. COLEMAN. Mr. Sims indicated that the liquidity of these various banks is much less than what its earned surplus on its sheets show and that in fact the real alternative available for marshaling funds from an institution to the Capital Corporation, which in turn would funnel it out to where it might be needed—Mr. Sims, would you correct me if I am wrong—is to do what Mr. Sethness says, the third alternative. And that is to increase its borrowings to fund such a transfer. Is that correct?

Mr. SIMS. That's correct. The liquidity funds that we have are funds on the balance sheet that are requirements of regulation as well as the business operations to meet our obligations. And I think as recently ago as within the last 3 months we received a letter from Governor Wilkinson admonishing us to increase our liquidity because it was not adequate at the present time, given the current environment. So, given that fact, any investments in the Capital Corporation today, as we did in both Spokane and Omaha, would be to borrow that money to invest.

Mr. COLEMAN. And do you——

Mr. SETHNESS. Mr. Coleman, if I may.

Mr. COLEMAN. Yes.

Mr. SETHNESS. The sending institution is going to have to increase its borrowings. The system as a whole should not have to increase its borrowings because the receiving institution will have funds that it has received that it will not need to borrow any longer. So, I think systemwide the borrowings need not change to have the surplus transfer take place.

Mr. COLEMAN. But they would become the responsibility and/or liability of a certain institution with the system.

Mr. SETHNESS. Right. The interest costs of the system as a whole should not change.

Mr. NAYLOR. Mr. Coleman, I am concerned that we keep that clear, because indeed what you're talking about is transferring of funds internal to the organization, who has responsibility for them.

We have had some concern before in some of these discussions. In effect what we are doing is double booking expenses and asserting you have to do it twice; you don't.

We're moving around assets internally. If the markets are adequately reassured, as we believe this would do, the total overall borrowing cost of the system would be reduced. And those savings could be passed on to farmers on a bank-by-bank basis, depending on their local operating situation.

Overall, this should provide reduced cost to the operators, more flexibility in the management of problem loans and working with operators in that regard, and some reassurance on the stockholdings. And that should be the net effect of this action.

Mr. COLEMAN. Mr. Wilkinson, do you care to comment on this issue as far as how this mechanically would work, the Capital Corporation, since you have some experience with a current organization? I am not sure it would be totally consistent.

Mr. WILKINSON. First of all, I think the explanation that has been most meaningful as we have attempted to work with this is that this truly would be a swapping, an exchange of the debt burden from one institution to another.

Second, it would be a consolidation of a particular type of asset. I think we recognize that, leaving out in the other institutions, the lending institutions themselves, those which are performing assets.

I concur with Mr. Naylor in that, if this Capital Corporation is effectively enabled to utilize the resources sitting out there in the system, there may be the real possibility of lowering the total borrowing and thus reducing to at least some limited degree the cost of interest which the American farmer is paying through his own cooperative system.

We concur in what has been said by our colleagues here.

Mr. JONES of Tennessee. Thank you very much, Mr. Coleman.

Now Mr. Weaver is recognized for 5 minutes of questioning.

Mr. WEAVER. Thank you, Mr. Chairman.

Mr. Wilkinson, you have been quoted in the Wall Street Journal and in testimony before this subcommittee on various amounts needed for cash infusion into the system. I think once $15 billion, once—well, give us the figures.

Mr. Wilkinson. I came before you last time with a recommendation that is still encompassed in the bill which we have submitted to this subcommittee. That is that what we believe is needed, sir, is a backup line of credit——

Mr. Weaver. No, no. You even quoted us figures. You cited actual figures. What were those figures you were quoted as saying?

Mr. Wilkinson. All right. We are talking in terms that within the next 2 or 3 years there are some $13 billion of nonperforming assets that have to be handled by this system.

Mr. Weaver. Thirteen billion is one of the figures.

Mr. Wilkinson. Thirteen billion.

It is our estimate, with a lot of unknowns, because we do not know what the economy, especially the agricultural economy is going to be indicating, that out of that $13 billion there will be some $5 to $6 billion charged off, Mr. Weaver, and that——

Mr. Weaver. OK. That's what I needed

Mr. Wilkinson. All right.

Mr. Weaver. Mr. Sims said in his testimony today, I believe the quote was: "We are going to need it for sure, cash infusion." So, now Mr. Sethness, I know what you're trying to do here. In effect, you're trying to get the Treasury to underwrite this paper like Ginnie Mae bonds, et cetera. And then you hope the paper will sell on its own and you don't have to put any cash in. I understand that, no problem.

But as a person who was a real estate developer for 20 years, when I signed a collateral note I had to be prepared to come up with the money. And so, the Treasury had better be prepared to come up with the money. We're talking about $5 billion, $13 billion, whatever, $3 billion. All these figures have been bandied about. Where, Mr. Sethness, if you had to come up with the money and chose to do so, where would the money come from, under the terms of this bill?

Mr. Sethness. From borrowings in the public market.

Mr. Weaver. All right. And would that increase the deficit?

Mr. Sethness. It would increase the debt.

Mr. Weaver. So, we would, if you had to come up with $3 billion, we would be increasing the deficit by $3 billion, the national debt by $3 billion?

Mr. Sethness. Yes.

Mr. Weaver. So, what we have here is a new corporation, the Farm Credit System Capital Corporation, or FARCE, set up to take the bad paper from the Farm Credit System. And if all things don't go too well—and I see no reason in the world things well, I see no reason why farm income is going to go up in the foreseeable future—you're going to be called upon to buy that paper under terms of this bill if enacted into law, thereby increasing the national debt. Correct?

Mr. Sethness. Subject to the discretion of the Secretary of the Treasury.

Mr. Weaver. Yes, I said—I understand.

All right. I am down to my last question, Mr. Chairman. I am sure that the chairman himself has been, I think, very generous with his own time in this subcommittee, and I thank him for it.

Mr. Sethness, in the event there is—suppose we had no bill. In the event there is a downsurge in the value of the Farm Credit System paper, I mean a real investor panic, and they get out.

We had one witness, Mr. Chairman, was it Salomon Bros., who said he was getting out of the paper now. He said he was—Goldman Sachs. He said he was not going to—he was getting out of what he had, and he was not going to buy any more. That was testimony before this subcommittee.

Do you fear, Mr. Sethness, that if that happened, the downsurge in the value and investor panic in Farm Credit System paper, that this would affect various other financial instruments, Treasury bonds, other kinds of bonds and paper out in the financial markets?

Mr. SETHNESS. If your scenario were to develop, I don't think there would be any risk for Treasury bonds themselves. They would in fact probably sell better as people fled to quality. But I do think——

Mr. WEAVER. Therefore, it wouldn't cost the—if we didn't have this bill and this panic ensued, it wouldn't cost the Government, the Treasury higher interest rates on its own paper?

Mr. SETHNESS. That's true. I do believe that there could be other ripple effects in the economy for other borrowers of many kinds.

Mr. WEAVER. Thank you very much. Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Weaver.

Now the Chair recognizes Mr. Cooper Evans.

Mr. EVANS of Iowa. Thank you, Mr. Chairman.

I have some questions to direct to the FCA or the Farm Credit System. I am not sure who would care to respond. But I notice in the new bill there are substantial powers to establish the interest rates that would be charged to farm borrowers. I also notice words in the section that talk about the powers of the FCA to obtain court orders to influence the operational functions of the institutions.

I am particularly concerned about words that say substantial dissipation of assets as the basis for a court order. And my question relates to interest rates and is this: Do you anticipate that that term and your power to regulate interest rates in other parts of the bill will be used to ensure that existing earned surpluses are not dissipated to stockholders and the borrowers in the form of lower interest rates?

Mr. DUNCAN. Congressman Evans, let me respond for the Farm Credit Administration on this. First of all, the agency is proposing to get out of the business of regulating interest rates.

Second——

Mr. EVANS of Iowa. But the act does specifically give those powers to the FCA, right?

Mr. DUNCAN. In the event—I'll have to ask my attorney on that language. I think that, to the contrary, the act would provide for the agency to get out of the regulation of interest rates——

Mr. EVANS of Iowa. But it also says you can get a court order if there is substantial dissipation of assets which, in the case of existing earned surpluses, could mean cutting interest rates——

Mr. DUNCAN. That is a different question, sir——

Mr. EVANS of Iowa [continuing]. To the farmer in order to reduce that.

Mr. DUNCAN. That is a question related to safety and soundness of the institution's regulating of the capital level, capital base in those institutions. And the language in the House legislation related to intermediate enforcement authorities is indeed similar if not identical, to the language that is available to other financial regulation agencies.

Mr. EVANS of Iowa. Well, if I may pursue that just a bit further then, what you're saying to me is that if there is an association out there today that has a very substantial earned surplus and recognizes that someone is likely to come down the road and commandeer that surplus to help fund the Capital Corporation, and that association decides that it would be more in the interest of its farmer borrowers to significantly reduce interest rates and allow that earned surplus to be reduced, you're saying it would not be the intention under this act for the FCA to step in and say: hey, we're going to seek a court order to prevent that from happening, as long as it did not threaten the soundness of that particular institution——

Mr. DUNCAN. To the contrary. As you define the question now, the agency would be in a position to regulate earnings and retention of earnings but not interest rates.

Mr. EVANS of Iowa. Well, the example I gave you was that they would be reducing their earned surplus by reducing their interest rates, so that over the period of the coming months or year, the earned surplus came down because of reduced earnings by virtue of those reduced interest rates.

Mr. DUNCAN. The agency, under its intermediate authorities, would have some ability to intervene in the case that you have just laid out to prevent an institution from essentially avoiding carrying its responsibilities with the system.

Mr. EVANS of Iowa. Thank you.

Mr. DUNCAN. And would intend to do so.

Mr. EVANS of Iowa. Thank you.

The next question, and I guess I would ask this to anyone who wishes to respond. In regard to going out and commandeering earned surpluses, to what extent do you expect court tests and litigation to determine the constitutionality, for example, of the act as it's presently written? Or what assurances can you give us that we aren't getting into that kind of a thicket?

Mr. SETHNESS. Our hope is that the authorities will be clear enough in the legislation that there need not be any court tests of it, which is one of the reasons that I raised in my testimony the concern over FCA's authority to regulate the transfer of surplus, and would urge the committee to leave the existing provision, which I think is 5.18(11), the way it is.

Mr. EVANS of Iowa. Which goes back to the point we talked about earlier.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Evans.

Mr. Glickman, you are recognized.

Mr. GLICKMAN. Thank you very much.

If possible, for these three questions I would like to get as quick an answer as possible. Mr. Sethness and Mr. Naylor, do you believe that the bill as introduced is in conformity with the provisions of the Gramm-Rudman budget plan?

Mr. SETHNESS. I have no idea.

Mr. GLICKMAN. OK.

The second question, I am not sure any of us really know what's in it, but I want to know how you all feel about it. The second question is one of the most sensitive issues in the bill is the method and degree to which stronger banks within the system are assessed by the Capital Corporation in order to help weaker banks.

And this I would ask of the system. You know, we have some "have districts" like Springfield, and Baltimore, and the Texas district. Then we have some "have not" districts. These are overstated, but that's Omaha, Spokane, Wichita, Louisville. And then there are a whole bunch that are kind of in between. You know, the bill would permit assessments, basically permit the haves to be assessed to help the have nots. I wonder how you are going to do that in a way that is consistent with sound business practices but at the same time not imperiling the financial viability of the contributing institutions.

You know, I don't want to see civil war developed within the Farm Credit System. This is the kind of issue that could create that. It has already started some of the skirmishes.

I wonder if you might perhaps define, maybe further refine some of the criteria.

Mr. SWACKHAMER. Your question is an important one to the system and to the issue. The mechanism does exist. We are doing that now through loss sharing. It looks like in fact capital preservation agreements will be triggered at yearend. So, it is painful for contributing districts. But I have been able to argue effectively with my board as a contributing district that it's in our best interest to help ourselves. We do have——

Mr. GLICKMAN. You're from a "have" district, right?

Mr. SWACKHAMER. I hope so.

Mr. GLICKMAN. OK.

Mr. SWACKHAMER. Yes.

Mr. GLICKMAN. At least they have you.

Mr. SWACKHAMER. Yes, I am president of the Baltimore Farm Credit Banks.

It's in our best interest so long as the effect on the financial markets is perceived to be beneficial, and therefore we can fund ourselves successfully by acquiring money even albeit at a higher spread. It's essential to the flow of funds in the agricultural sector that it be there.

And we have explained how we do that by issuing additional debt. But I think there is another important point. It is the point on which I would say Mr. Sethness and I have disagreed the most in recent weeks. That is the pooling of surplus from many corporations into one accessible place is not without a cost. The surplus of the institutions is now employed, and it's employed without a debt obligation behind it, because it has been earned. So, to utilize it means that in the future any repayment of Federal financial assistance or any building of an earned net worth surplus, which Mr. Sethness answered Mr. Evans as being the best contingency fund for the future, presumes that there must be earnings. And those earnings, I would argue, would have to be something more than the spread off of Treasury costs.

Mr. GLICKMAN. Could you see a day developing where the demands on districts like yours would be too much for you to handle? I mean, is that implicit in the legislation? Is that a possibility?

Mr. SWACKHAMER. I think given the legislation which we support, the mechanism is there to deal with that, because if interest rates become unreasonably high or if the viability of institutions is threatened, I think the obligation of the Farm Credit Administration and the Treasury would be to act.

Mr. GLICKMAN. OK, one final question because our time is almost up. I want to go to the issue that Senator Boren has raised on the Senate side on the issue of elections with respect to consolidations and mergers of some of the underlying organizations, PCA's and land banks.

How do you characterize the Boren amendment and what it will do with your plans pending any legislation that is passed? I wonder who might respond to that, Governor Wilkinson, Mr. Swackhamer. I particularly note the problems in the State of Oklahoma, where there seems to be some serious resistance to these elections.

Mr. WILKINSON. Yes; the Boren amendment, I think in so many words, freezes the merger, the consolidation issue until a given date. I think it's——

Mr. GLICKMAN. January 1, I think——

Mr. WILKINSON. January 1; Mr. Glickman, thank you.

One of our concerns is that in a sense that is negating the authority and the vote of the actual stockholders in those associations. And as you so well know, that voting is underway right now in several——

Mr. GLICKMAN. Does that cloud the elections that are occurring now as far as you're concerned? Does that put a cloud or an impairment on these elections, that amendment?

Mr. WILKINSON. I would say that it does cloud the overall effort which certain districts, including the Wichita district, are attempting to bring about through the legal process of stockholder votes, the consolidation of the capital. And it, I think, seriously raises some question as to whether the intention as evidenced in your bill could be fulfilled. And that is the effective utilization of the resources of the system.

Mr. SIMS. Mr. Glickman, if I might address that, I am from a district that has been going through this for nearly 3 years. We got caught up in this amendment. As we began to see the problem developing, we took to the farmer boards in the St. Louis district the issue. They voted to merge and consolidate, starting some 3 years ago, before any discussion of any legislative process was underway. The PCA's voted overwhelmingly, 80 percent, 90 percent, and 90 percent in our three States. The land bank vote is next week.

So, we view this amendment as having in effect gotten in the way of the most basic stockholder right, and that is their decision to do what their organizations as they see best fit, given the environment that they are in.

Mr. **GLICKMAN**. Thank you very much.

Mr. **NAYLOR**. Mr. Glickman, might I take just a moment?

Mr. **GLICKMAN**. Sure.

Mr. **NAYLOR**. Your observation about a war moving, as you characterize it, from the "haves" to the "have nots," I would add an additional caveat, if I may, to that: that you might well envision an even bigger war if institutions that are not strong defaulted on securities and triggered a problem that would immediately call all of the funds of the system to bear and——

Mr. **GLICKMAN**. Is that because of joint and severable liability of——

Mr. **NAYLOR**. That is joint and severable liability.

And also, if we do not successfully address the problems the system faces, there will be increased cost to all users, including those that have surplus funds. This will effect what they would have to charge individual producers. Basically, we are trying to address how to provide some assistance, relief for individual farmers.

Mr. **GLICKMAN**. Well, I agree. I think you really have one system, not severable different systems, myself.

Thank you, Mr. Chairman.

Mr. **JONES** of Tennessee. Thank you, Mr. Glickman.

The vote is almost ready for us to depart here. I am going to conclude the session without any questions of my own. But I will take the privilege of continuing to contact any of you that it is necessary for me to do so.

I want to thank all of you, all six witnesses, for being here. You have done a super job.

I think that we have got a good bill. I think that we will go home for this recess and come back and make the changes that are necessary. We will find out what needs to be done in these days that remain.

Mr. Coleman and I have made a decision that the markup will be on Tuesday, December 3, by this subcommittee. I ask the staff to make the arrangements and to notify all members of that date.

The subcommittee stands adjourned.

[Whereupon, at 12:35 p.m., the subcommittee was adjourned, subject to the call of the Chair.]

[Material submitted for inclusion in the record follows:]

FOR RELEASE ON DELIVERY
EXPECTED AT 10:00 a.m.
November 21, 1985

STATEMENT OF CHARLES O. SETHNESS
ASSISTANT SECRETARY OF THE TREASURY (DOMESTIC FINANCE)
BEFORE THE
SUBCOMMITTEE ON CONSERVATION, CREDIT AND RURAL DEVELOPMENT
OF THE HOUSE AGRICULTURE COMMITTEE

Mr. Chairman and Members of the Subcommittee:

I appreciate this opportunity to appear before you to discuss H.R. 3792, the "Farm Credit Act Amendments of 1985."

I want to open by expressing my high regard to the full Committee, this Subcommittee, and their staffs for their expeditious and substantial effort in drafting this bill. The legal and financial subjects are complex, the participants can be contentious, and time has been short. We all recognize that there is need for reform to enable the Farm Credit System (FCS) to take self-help actions to remain a viable lender for America's farmers and reassure concerned capital market investors. I compliment this Subcommittee on its effort to get the ball rolling.

The Administration's Position on Self-Help Powers for FCS and the Reform of FCA

The Administration recognizes the vital role that the FCS plays for the country's farmers. It is alert to the need to maintain the System as a privately owned organization that is sensitive to market forces. We are monitoring closely the sizable loan losses that the System expects to incur over the next few years.

We have urged the Congress to take two actions as quickly as possible to help the FCS solve its current problems and avoid future difficulties. First, the FCS needs legislative authority to mobilize fully its substantial earned surplus ($5.5 billion as of September 30, 1985) to absorb operating losses and manage troubled loan assets. FCS must have an effective capability to pool and quickly allocate its considerable resources to cope with localized problems. All the System's resources should be available to cushion borrower stock and to permit the more orderly restructuring of loans.

Second, we need to transform the Farm Credit Administration (FCA) into an independent financial regulator that has the will and the tools to supervise the FCS effectively. FCA has had neither the full capability -- nor the proper separation -- to assess, cope with, and prevent the recurrence of FCS's financial problems before they expand.

H.R. 3792 seeks to address both these points. While we have not had time to subject the bill language to close scrutiny, I believe that H.R. 3792 incorporates most of the critical reforms. Naturally, we are reviewing the bill carefully and will report later on any technical suggestions we may have. I will note later in this testimony some important features of the bill that the Subcommittee may wish to review. We are, of course, willing to assist the Subcommittee in making those adjustments that will enable the legislation to accomplish the results we all seek.

Unfortunately, H.R. 3792 also contains a financial "backstop" provision that the Administration believes is the wrong approach, at the wrong time, leading to a possible wrong result.

H.R. 3792's Financial Assistance Component

H.R. 3792 authorizes the Secretary of the Treasury, at his discretion, to purchase obligations of the FCS Capital Corporation. This provision is inappropriate on two counts.

First, the System does not now need the Government's financial support in any fashion. It has a capital base that would be the envy of other financial institutions. As of September 30, 1985, the FCS had earned surplus of $5.5 billion, loan loss reserves of $1.6 billion, and member stock totaling $5.3 billion. Even accepting the FCS's and the FCA's estimated loan losses of between $3 billion and $5.5 billion for the remainder of 1985 through 1987, the System has the retained earnings and reserves to sustain its losses while maintaining a cushion for borrower stock. At a minimum, it is clear that the FCS does not have any immediate need for financial assistance.

Second, I am also concerned that the inclusion of financial assistance language would require the proper additional review by other committees. This review would certainly slow down the legislative process at a time when farmers, investors, and the Government need prompt action. Furthermore, a bill that incorporates financial assistance will necessarily involve longer consideration by the Senate.

Specific Provisions of H.R. 3792

Based on a preliminary review, the Administration recommends nine adjustments in H. R. 3792. These changes should ensure that the FCA becomes an effective financial regulator and that the FCS operates an efficient, accountable lending business that serves America's farmers. We also have some more technical comments that we would be pleased to supply to your staff.

1. FCA's Power to Regulate the Transfer of Funds

We note that H.R. 3792's restatement of the FCA's powers adjusts the FCA's authority over the transfer of funds within the System. The redesignated section 5.17(a)(6) permits the FCA to establish standards for the transfer of funds. Current law authorizes the FCA "to regulate" such transfers, and the FCA has interpreted this authority to include the power to direct transfers of funds.

The Administration believes it is absolutely critical for the FCA to retain its present authority. Indeed, H.R. 3792 seems to presuppose this retention, because it makes the FCS Capital Corporation's assessment powers subject to the FCA's regulation. The change in language in the new section 5.17(a)(6) may have been the inadvertant result of joining this FCA power with another dealing with loan security requirements. We strongly urge the Committee to restate the exact language of current section 5.18(11).

2. FCA's Power to Require Surety Bonds

H.R. 3792 drops FCA's authority to require surety bonds (section 5.18(15) under current law). This provision ensures that FCS institutions are protected against losses caused by employees. We cannot understand why H.R. 3792 deletes this authority, which provides for a protection common to financial institutions. Indeed H.R. 3792's own language regarding the Capital Corporation (new section 4.28H(a)(3)) recognizes the importance of surety bonds. We recommend that current section 5.18(15) remain among the FCA's specified powers.

3. Establishing the Value of Assets Purchased by the Capital Corporation

The list of powers of the Capital Corporation includes the authority to purchase nonaccrual loans and acquired assets (new section 4.28(H)(a)(16)). The language stipulates that the purchases be at "current value," which is described as the "value disclosed in the most recent examination of such institution...by the Farm Credit Administration."

We urge the Committee to substitute the phrase "fair market value" for "current value" and to grant the FCA authority to regulate its determination. We fear that the phrase "current value" does not have a generally understood meaning. Moreover, it would be inappropriate to purchase assets at a value determined through an examination that might have taken place months before. We would expect that the Capital Corporation would seek a current appraisal before it purchased an asset.

Our proposed change is significant because it ensures that the Capital Corporation will expend other FCS institutions' surplus in an equitable manner. When the Capital Corporation buys an asset, it should receive the fair market value for which it has paid. The Capital Corporation would, of course, continue to have the authority to allocate funds to System institutions whose viability was threatened.

4. The Capital Corporation's Authority to Borrow

H.R. 3792 authorizes the new Capital Corporation to borrow money on its own and through System-wide bond issues (new sections 4.28H(a)(11),(12)). We strongly recommend that the Capital Corporation only be authorized to raise funds through System-wide debt issues (i.e., to delete section 4.28H(a)(11)). It is imperative that the Capital Corporation not be seen, both inside and outside FCS, as an entity separate from the other System institutions. Since the Capital Corporation will be purchasing bad loans from FCS institutions, they must share responsibility for its performance and obligations.

Furthermore, new section 4.28H(a)(12) may necessitate a technical change to ensure that the Capital Corporation remains jointly and severally liable with System banks. As drafted, the bill states that the Capital Corporation must satisfy the requirements of section 4.3 to be jointly and severally liable. The new section 4.3 establishes capital requirements. If the Capital Corporation did not meet these requirements, one might assert it was no longer jointly and severally liable. It would be far preferable to add a "c" behind "section 4.3," thereby limiting the requirement to the collateral standards for banks participating in System-wide debt issues.

5. The Capital Corporation's Power to Issue Regulations

Sections 4.28(H)(a)(14)(A) and (B) authorize the Capital Corporation to issue regulations pertaining to FCS institutions' provision of assistance funds to the Capital Corporation. These sections appear to be directed at evaluating how much capital is available and enforcing compliance. We believe it is a serious mistake to mix again the regulator with the regulated by granting these powers to the Capital Corporation (including, it appears, the authority to issue enforcement directives). Nor are these powers necessary to achieve what appears to be the purpose of these provisions.

First, H.R. 3792 already contains a requirement (new section 4.1) that FCS institutions must pay assessments and contribute capital to the Capital Corporation. Second, in the event an FCS institution will not comply, we should leave the task of enforcement to FCA, the true regulator. Otherwise, we will in effect have two regulators, with one being an independent System corporation. Finally, to protect FCS institutions against assessments that may threaten their viability, one can either: (a) grant FCA the power to set the appropriate standards; or (b) note in new section 4.28H(a)(13) that the Capital Corporation's power to require stock purchases and assessments must not imperil an institution's viability or preclude it from supplying credit on reasonable terms.

5. The "Escape Clause" from GAAP Reporting

We recommend that the Committee narrow the "escape clause" it has appended to the requirement that System institutions file annual financial reports in compliance with generally accepted accounting principles (GAAP). Everyone who has struggled to understand the FCS's current difficulties has bemoaned its accounting problems. The authorization to the FCA to make exceptions to the reporting requirement is probably based on a well-disposed intent to permit the FCA to require "more stringent" accounts, but the effect is to open an ill-defined loophole. Loopholes can become financial chasms when pressures build on a regulator.

This System is in dire need of uniform, consistent, accurate, and independently audited financial reports in a form understood by outside investors and analysts. That is what GAAP is all about. We should not lightly permit departures from it.

We suggest that the Committee substitute two narrowly drawn exceptions to the rule that all FCS institutions prepare independently audited financial reports according to GAAP. First, the FCA must have authority to establish temporary accounting rules to govern the reporting of new or unique circumstances not yet addressed by the Financial Accounting Standards Board (which establishes GAAP). Second, the FCA should be able to permit consolidated financial reports of System institutions where it determines that presentation is sufficient.

7. Surplus Formulae

Current law contains numerous formulae that dictate how System institutions are supposed to build up earned surplus. These formulae are no longer necessary once the FCA has authority to set capital requirements, and they might pose obstacles to the System's ability to pool its surplus. We recommend that the Committee delete these formulae while maintaining the FCA's authority to regulate dividends.

8. Merger Powers

We recognize the sensitivity of the merger issue among the FCS institutions. But we believe that the present financial problems and high-cost inefficiencies within the System necessitate at least some modest merger powers.

First, we recommend a provision authorizing voluntary FCS mergers of like associations within a district if the merger is approved by either (a) two-thirds of the associations in a district (each approving association would require a majority vote of its shareholders), or (b) a three-fourths vote of all the association shareholders in the district. The FCA also would have to approve the merger. This change would make a district-wide association merger possible where the vast majority of associations or shareholders seek it. Under current law, one association can halt a merger sought by all others in its district.

Second, the FCA needs the limited authority to require a merger of two banks operating under the same title when one can no longer meet its obligations. Under present law, if a bank cannot meet its obligations, the FCA must declare the bank insolvent and liquidate it. Such a liquidation would be disruptive to the System, its borrowers, and the creditors of the liquidated bank. An FCA-directed merger in such a situation, after consultation with the district boards, would enable the FCA to manage an impending bank failure more effectively and less expensively.

9. New Enforcement Power Language

The Administration agrees wholeheartedly with the new enforcement powers that H.R. 3792 would grant the FCA. But the language employed would cause problems for the FCA in practice.

H.R. 3792's language appears to be a good faith attempt to clarify and streamline the statutes on which essentially all Federal banking and thrift regulators rely. That statutory language is highly technical and precise. The courts are familiar with it, having applied it in countless cases. By employing revised and edited language, H.R. 3792 would be interpreted as intending different enforcement treatment in numerous situations. Yet we would wish FCA to have the same effective enforcement powers now possessed by all other Federal financial institution regulators.

Therefore, we urge the Committee to employ the same basic enforcement language relied on by the other regulators.

Conclusion

The Administration recognizes the vital role that the Farm Credit System plays for the Nation's farmers. We understand the urgent need to maintain the System's vitality. To alleviate the FCS's current problems and establish a permanent solution, we strongly support those provisions of H.R. 3792 that would (1) enable the Farm Credit System to deploy its own substantial resources to solve its localized financial difficulties, and (2) reform and strengthen the Farm Credit Administration. We believe that the establishment and effective operation of the Farm Credit System Capital Corporation and the reinvigoration of the Farm Credit Administration as a strong regulator will achieve our common goals without the need for Federal financial assistance.

The President has decided that the Administration will further assess the FCS's need for Federal financial assistance, but only if the Congress is willing to legislate the restructuring and self-help changes we all want to achieve. The Administration is committed to a reassessment of the financial assistance question once the necessary reforms have been implemented.

It is crucial that legislation be enacted expeditiously to reform the FCA and to enable the FCS to muster its own considerable resources to help farmer borrowers. We will work with you to pass such legislation. However, we are concerned that the inclusion of financial assistance provisions, which we cannot support, would make it virtually impossible to enact this legislation promptly. I look forward to working with you, your Subcommittee, and the full Committee to resolve these important issues.

STATEMENT OF DONALD E. WILKINSON
GOVERNOR, FARM CREDIT ADMINISTRATION

BEFORE THE SUBCOMMITTEE
ON CONSERVATION AND CREDIT, OF THE
HOUSE COMMITTEE ON AGRICULTURE

November 21, 1985

We commend Chairman de la Garza, Mr. Madigan, Chairman Jones and Mr. Coleman for introducing consensus legislation to address the pressing problems of the Farm Credit System and the Farm Credit Administration. We are pleased that the major provisions of their bill is consistent with the recommendations FCA submitted in the form of a bill on November 8.

While there are differences between what we proposed and what has been introduced, we support your efforts and pledge ourselves to working with you in the days ahead. We also appreciate the importance which has been attached to giving prompt consideration to this measure and to its rapid implementation upon enactment.

First, your bill provides for the establishment of a new Farm Credit System Capital Corporation to centralize and manage the distressed assets of System institutions and to receive and administer System financial self-help and outside financial assistance.

It is critical to the success of this effort that further consideration is given to measures to strengthen the effectiveness of the Farm Credit System Capital Corporation (FCSCC). Specifically, we recommend that authority be granted to the Chairman of FCA to appoint the five FCSCC board members from among the most qualified individuals available with the understanding that the majority of directors may be outside directors who are not affiliated with the System. Further, FCA's chairman should appoint the chairman and chief executive officer of the FCSCC from among its five board members.

Second, your bill provides for a restructuring of the Farm Credit Administration and expansions of its regulatory authorities to achieve strength and independence. As you know, since February of this year we have been urging Congress to enact the kinds of intermediate enforcement authorities that are contained in your bill. We therefore, fully support extention of these authorities to the FCA.

We also recognize the need for establishing an appropriate arms-length relationship between FCA and the System.

The legislation we submitted to you on November 8 suggests a board and chief executive officer structure that we believe preserves the independence of the agency while assuring proper public accountability and arms-length relations between the regulator and the regulated.

While we believe the provision in your bill making the chairman of the board and chief executive officer subject to Presidential appointment and Senate confirmation for a six year term, is consistent with our objective to preserve the independence of the Farm Credit Administration, we believe that it would be more appropriate for the Presidentially appointed board to select the chairman.

We are concerned that the provisions in your bill establishing five permanent board members will weaken the chairman's ability to administer the Agency.

To avoid the operational difficulties associated with multiple full time board members in a relatively small organization like the FCA, we recommend that four directors serve on a part-time basis. We point out that our legislation effectively severs part time directors from System affiliation.

Finally, your legislation provides for backup federal assistance in the form of a line of credit to the FCSCC on terms and rates of interest subject to discretion of the Secretary of the Treasury.

We believe that your bill is consistent with the line of credit models that are contained in statutes governing the Federal National Mortgage Association and Student Loan Marketing Association. FCA therefore supports this provision of your bill provided it is Congressional intent that the terms and rates of interest of credit extended should be set by Treasury at a level that will protect System access to credit markets and protect the System's ability to fulfill its Congressional mandate to provide sound and constructive credit to creditworthy farmers.

A line of credit at market rates of interest will not stop or slow the financial deterioration of the System or its individual institutions. It may provide some confidence to the market,however, by evidencing the Federal governments concern.

Mr. Chairman, there are a number of specific and technical concerns that we will share with you and your staff as you refine this legislation. We support your efforts to achieve prompt consideration and enactment of consensus legislation. We pledge ourselves to work with you toward this end.

STATEMENT OF DOUGLAS D. SIMS, MEMBER, LEGISLATIVE COMMITTEE, THE FARM CREDIT COUNCIL

Mr. Chairman:

Yesterday, the Chairman and the Ranking Minority Member of the Agriculture Committee and the leadership of this Subcommittee took an important step on behalf of the farmers, ranchers and cooperatives who own and direct the Farm Credit System.

We commend you, Mr. Chairman, Mr. de la Garza, Mr. Madigan and Mr. Coleman for focusing the attention of Congress on this issue and for highlighting the importance of adequate and reasonably-priced credit to farmers and their cooperatives. Your dedication and perseverance on this complicated and controversial issue has made the difference.

The introduction of H.R. 3792 provides a clear signal to other Members of this Committee and the Congress. It demonstrates strong, bipartisan support for the Farm Credit System as a provider of credit and other services to agriculture. It responds to an urgent need. Most importantly, it shows agreement that the Farm Credit System must have a mechanism in place before this session of Congress adjourns to provide financial assistance whenever it becomes necessary.

Let me begin by saying that the Farm Credit System is in strong support of the intent and the thrust of this legislation. This bill captures the critical issues which need to be addressed in an effective, concise manner:

o **the strengthening of farmer-borrower rights;**

> Farmers must clearly understand their rights and responsibilities in the borrower/lender relationship.

o **the restructuring of the Farm Credit Administration into an effective, arms-length regulator;**

> Investors in Farm Credit System bonds must have confidence in the regulator and the regulatory mechanism.

- **the mechanism for triggering financial assistance to the Farm Credit System and its institutions and associations;**

  Unless there is a dramatic turnaround in the agricultural economy, such a mechanism will be needed in the near future.

- **the safeguards on pooling capital of System banks and associations so that neither farmer-cooperative stock, nor financial viability of institutions, are imperiled;**

  Fairness and equitability must guide the pooling of capital. Contributing districts and their farmer-borrowers should not be penalized as a result of the movement of capital.

- **provisions to allow mergers or liquidations to continue with majority stockholder votes;**

  This is the very essence of grassroots' control and stockholder rights.

- **the statutory continuation of a financial warehouse for non-accrual loans and acquired properties;**

  The existing Farm Credit System Capital Corporation is a tested self-help mechanism for dealing with problem loans from the Spokane District. We expect that it will serve an expanded function equally well.

- **the provision for financial assistance.**

  We are greatly encouraged that the bill provides the maximum flexibility to the Secretary of Treasury to allow government assistance to match the financial needs of the Farm Credit System. We applaud you for this, because financial assistance will be needed! Our present estimate of that need is $6 billion, or $1.5 billion a year for four years. This figure is closely tied to the financial health of our farmer-borrowers. We continue to believe that profitability for agriculture is the best way to keep the System's need for assistance to a minimum.

We do have some comments on a few other issues which are fundamental to the Farm Credit System and its farmer-cooperative owners. These are:

- the discretionary authorities of the Secretary of the Treasury over the terms and conditions for repayment of any loan;
- the composition of the Capital Corporation board of directors; and
- the role and responsibilities of a restructured Farm Credit Administration.

H.R. 3792 will ultimately be judged in the context of the commitment by Congress to support farmers and their Farm Credit System. We believe that this mechanism for providing financial assistance is a sound one. It confirms Congress' unequivocal commitment to stand behind the Farm Credit System. It gives critically needed reassurance to farmers who own stock and borrow from the System. It also assures the tens of thousands of investors who buy Farm Credit securities. And it again reinstitutes the long-standing partnership between government and farmers in providing dependable credit at reasonable rates.

As we have testified previously, financial assistance will help the Farm Credit System to:

- **pursue a more flexible forbearance policy;**
- **ensure more reasonable interest rates for farmers;**
- **allow a more orderly and manageable process of selling inventoried properties;**
- **ease the pressure for the accelerated collection of delinquent loans; and**
- **allow farmer-owners to proceed on a more thoughtful and timely basis for making decisions on the most effective service delivery mechanism.**

The System would like to see the current bill language modified for several reasons.

Our first major area of concern relates to the authorities of the Secretary of the Treasury over terms and conditions for the repayment of financial assistance. Mr. Chairman, the above benefits, which we hope to achieve, can only be achieved with favorable terms and conditions of repayment from the government. Otherwise, it is only a substitute for obtaining funds in the capital markets and would not permit the Farm Credit System to assist agriculture in the difficult years ahead.

We believe it is important to define criteria such as what constitutes a "reasonable rate of interest" or a "viable organization." This definition will assist you and the Farm Credit System as well. As we testified, maintaining the viability of System institutions is essential to any proposal. It defeats the objectives of the Farm Credit System to have banks who contribute to the Capital Corporation become either noncompetitive in their region or worse yet, non-viable. Any plan must meet the test that interest rates charged to farmer/cooperative borrowers are competitive within their geographic area and also cover the costs of business operations over time.

Our second area of concern is the composition of the Capital Corporation board. We have heard from the Administration that they consider the Capital Corporation to be a System institution. We agree. The initial investment of capital in the Capital Corporation represents an investment of the assets of farmer-borrower-stockholders.

The Capital Corporation's proposed new role makes it, for the forseeable future, the most powerful institution in the Farm Credit System, because of its broad powers over most System operations. To place this key unit under the direction and control of a "government" board would have the effect of federalizing the Farm Credit System.

This legislation proposes that the Chairman of the Farm Credit Administration be appointed by the President, and the Capital Corporation

Board be appointed by the Chairman of the FCA. Thus both the FCA Chairman and, through him, the Capital Corporation Board would be "political" appointees, in effect, a "government" board. This proposal is inconsistent with the intent to have the System regulated by the government at "arms length."

Our third area of concern relates to the Farm Credit Administration (FCA) as an "arms-length" regulator. We believe this function must be detached from operational, management and policy decisions of the organization it is regulating. The FCA's primary function should be that of a regulator-examiner to ensure, in the public interest, the safety and soundness of the System institutions.

However, while FCA, itself, supports the change to an "arms-length" regulator, this legislation would continue FCA's past role. In particular, FCA would continue to have the authority to involve itself in operational and day-to-day business decisions through case-by-case "prior approvals". It would continue to be enmeshed in the day-to-day operations of System institutions. This is fundamentally inconsistent with the role of an "arms-length" regulator.

In conclusion, Mr. Chairman, we want to reiterate our belief that this legislation must be enacted in this session. Action is needed now to avert two potential crises of profound significance for American agriculture. The first is a potential funding crisis. It is critical that investor confidence in the Farm Credit System be restored immediately. The second is a potential financial crisis. Further declines in farm real estate values and the continued absence of profitability for farmers will only deplete the financial resources of the Farm Credit System of its borrower-stockholders.

Federal Land Bank Associations
Production Credit Associations

P.O. Box 509
Fostoria, OH 44830
(419) 435-7758

Subcommittee Chairman Ed Jones
House Ag Subcommittee, Conservation, Credit
and Rural Development
1301 Longworth House Office Building
Washington, D.C. 20515

Dear Sir:

This letter is in the nature of written testimony on H.R. 3792. When we learned of the substance of this legislation in the November 19, 1985 edition of the Wall Street Journal, our attorney asked that one of us be permitted to testify on the legislation. He was informed that the witness list was closed but that testimony could be submitted in this form.

Production Credit Association of Northern Ohio

We are the directors of Production Credit Association of Northern Ohio, which was chartered by the Governor of the Farm Credit Administration on March 19, 1934. Our headquarters is in Fostoria, Ohio, but our lending business is conducted in Hancock, Wood, Lucas, Ottawa, Sandusky, and Seneca counties, Ohio. We have approximately 2,500 farmers in these counties who own stock in the PCA and are borrowers from it.

The counties in which PCA of Northern Ohio operates are among the state's most productive in a number of different commodities. For example, Wood county ranks first in wheat production, second in soybean production and third in corn production in Ohio. Hancock county is first in soybean and second in wheat production. Seneca county is third in soybean production. Sandusky county is first in cucumbers, processing tomatos, and sugar beets. Our lending territory also includes fruit, vegetable, and greenhouse operations as well as beef, dairy cattle, hogs, sheep and poultry.

In the thirty-five year period from 1950 to June 30, 1985, PCA of Northern Ohio loaned more than $1,000,000,000. It has had less than $1,000,000 in cumulative loan losses from the date it was chartered in 1934 until June 30, 1985. The association has been and continues to be profitable despite what many regard as the most adverse agricultural conditions in fifty years. It has been and is the largest agricultural lender within the six county area. We attribute this to several factors. First, the farmers with which we do business have had a great deal of confidence in the strength of the PCA. When they borrow money they are required

Part of the Farm Credit System

to invest an amount equal to eight percent (8%) of the loan and to maintain their investment at that ratio during the life of the loan. They have always been confident that this eight percent (8%) investment can and will be returned to them as the loan is paid. Second, the PCA has historically loaned money at very favorable rates, typically as low as any production credit association in the Fourth Farm Credit District, comprising Ohio, Indiana, Kentucky and Tennessee.

These two factors, confidence and low interest rates, have combined to give the association a very significant market advantage over competing lenders. As a result, the association has been able to attract the best of the agricultural credit risks and to enable these farmers to reduce their interest expenses, which results in a lower overall operating costs, further enhancing the ability of these farmers to operate successfully in a period of difficult economic times. In turn, this has enabled us to operate with minimal credit losses, which, of course lowers our operating costs.

Each of the factors discussed above is essential in our efforts to provide funds to our farmer-borrowers at the lowest possible costs. Without confidence that they could receive their investment in PCA stock upon payment of their loans, our farmers would borrow elsewhere. Unless our interest rates are competitive, it makes no sense for a farmer to do business with our association. Unless we can continue to operate the association in accordance with our existing credit standards, we cannot maintain a successful loan loss experience.

As a result of fifty years of prudent and successful management, our association has a net worth of an excess of $10,000,000. Computed in the way commercial banks calculate capital for purposes of complying with the banking agencies' six percent (6%) minimums, PCA of Northern Ohio has a capital/asset ratio exceeding fifteen percent (15%), more than two and one-half times that it would be required to maintain if it were a commercial bank. Even if our investment in the stock of the Federal Intermediate Credit Bank of Louisville were to become totally worthless, our resulting capital/asset ratio would be only slightly less than that required of a commercial bank. We do not ask that you accept our representations as to the financial condition of the association on faith. We have attached to this testimony copies of our financial statements containing the opinion of Coopers & Lybrand, Certified Public Accountants.

The Farm Credit Crisis and the Pooling of Capital Regulation

Recently, as agricultural conditions in the United States deteriorated, the quality of agricultural debt began to be called into question. Approximately fifty commercial banks with significant amounts of agricultural loans in their portfolios have now been closed. Also, the Farm Credit Administration revealed similar probelms in agricultural debt held by Farm Credit System lenders. As a result, negative accounts in the news media began to include mention of Farm Credit System securities. The yield differential between U.S. Treasury securities and those of the Farm Credit System, which had been almost insignificant, rose to approximately one-fifth of a percentage point.

A Farm Credit Administration regulation (12 C.F.R. § 611.1145) that was designed to calm the credit markets, has had an opposite effect. The regulation purports to give the Farm Credit Administration the authority to transfer assets and equities among Farm Credit System lenders. Immediately after it was adopted the interest rates on Farm Credit System securities increased from approximately one-fifth of a percentage point over the yield on comparable U.S. Treasury securities to approximately nine-tenths of a percentage point over Treasuries. According to accounts in the press, the market fears that the regulation will drive the better credit risks out of the Farm Credit System. Some provisions of H.R. 3792 pose the same threat to the ability of Production Credit Association of Northern Ohio to continue to operate.

H.R. 3792 and the Farm Credit System Capital Corporation

Section 4.28L of the Farm Credit Act. As added by section 103 of the bill, this section would grant the Farm Credit Administration unlimited authority to require Farm Credit System institutions such as ours to contribute capital to the Farm Credit System Capital Corporation. This poses a direct and immediate threat to the farmers who have invested in our association. A crisis in confidence could trigger abandonment of our PCA (and other System institutions) by the most creditworthy borrowers. More importantly, even if the initial capitalization of the Capital Corporation does not result in the diversion of capital from our association, another provision in the bill will likely have the same result.

Section 4.28H of the Farm Credit Act of 1971. As added by section 103 of the bill, this section would authorize the Capital Corporation to require System institutions to make funds available to the Capital Corporation. Our PCA, which is considered among the most solvent in the Fourth Farm Credit District, has already invested $8,131,000 in the Federal Intermediate Credit Bank of Louisville, including $609,000 invested in the first eight months of this year. Stock in PCA of Northern Ohio held by our borrowers amounted to $6,146,000 as of August 31, 1985. In other words, Production Credit Association has already invested in the FICB more than the amount invested in the PCA by its farmers-borrowers.

Our investment in FICB stock has increased from $6,643,000 at year end 1983 to $8,131,000 at the end of August. At the rate we are going, all of our net worth will be tied up in FICB stock by the end of 1986. As a result, it seems probable that the Capital Corporation would very quickly begin to take the stock held by our borrowers. Before that happens we would expect the borrowers to go elsewhere for their credit needs, the most creditworthy going first. Our PCA will then rapidly be left with no customer base. Those farmers who stay with us will find their net worths decreasing as the value of their investment in the PCA declines.

Even if the Capital Corporation were to be financed with debt instruments issued to PCAs rather than with stock, unless PCAs receive a market rate of return, the transfer of funds to the Capital Corporation would quickly bankrupt the association. Our association does not have access to interest free money, nor does it maintain idle balances. For every dollar diverted to the Capital Corporation, our PCA will pay interest. The association already pays approximately $350,000 per year under a loss sharing agreement, in addition to interest on its note to the FICB. Any additional expense not offset by revenue will severly reduce our profitability, requiring that interest rates be increased above those of competing lenders, driving away our better credit risks.

We believe that the Farm Credit System as a whole cannot long survive by bleeding healthy PCAs in an attempt to save those already beyond salvation. The recent action of the Farm Credit Administration in administratively authorizing pooling of capital did not calm the fears of the credit market, but seemed instead to aggravate those fears. We believe that there can be no confidence in Farm Credit System Securities unless the credit markets can be sure that the Farm Credit System retains the confidence of the farmers. Because sections 4.28H and 4.28L would place the farmers' investment in PCA stock at risk, it will not solve the crisis of confidence.

Sincerely,

Carl H. Bensch

Carl Bensch - Chairman of the Board

Dean Biery

Kenneth Hoot

Ray Murray

Robert Borough

Directors of Production Credit
Association of Northern Ohio

cc: Ohio Delegation

(Attachment is held in the committee files.)

**Farm Credit Banks
of Springfield**

Federal Land Bank
Federal Intermediate Credit Bank
Bank for Cooperatives
Post Office Box 141
Springfield, Massachusetts 01102
413/786-7800

November 21, 1985

The Honorable Ed Jones
Chairman, Subcommittee on
Conservation, Credit, and
Rural Development
House Agriculture Committee
108 Cannon House Office
Building
Washington, D.C. 20515

Dear Mr. Chairman:

The Farm Credit Banks of Springfield wish to express their appreciation for the concern and interest you and your colleagues on the Agriculture Committee have taken in the very serious and complex problems now confronting our nation's farm credit system. A solution to the farm credit crisis must involve the Legislative and Executive branches of government as well as the banks of the Farm Credit System--a cooperative effort which we hope will result in assistance to a troubled farm credit system.

We have briefly examined the provisions of H.R. 3792 and view this legislation as an important starting point in a process which we believe must yield a fair and equitable mechanism to aid ailing farm credit institutions and their farmer borrowers, a more appropriate regulatory role for the FCA and federal financial assistance to the farm credit system in the form of a line of credit of the type now available to government sponsored agencies.

The financial strength of the banks and associations of the First District, which sets them apart from many other system institutions, gives rise to special concerns with the legislation before this Committee. Although financially strong today, the First District has the same needs as other farm credit institutions to plan for potential adversity.

The First District has provided leadership in past efforts to marshall the system's resources in order to aid troubled institutions. We recognize that the ultimate financial health of any Farm Credit District is dependent on maintaining the financial soundness of the entire system. In addition to our legal and ethical obligations to our sister institutions of the farm credit system, we must remain mindful of our fiduciary responsibilities to our more than 16,000 farmer and 100 cooperative borrowers.

In this respect, we are concerned with provisions in H.R. 3792 which would require pooling of resources without quantitative limits or adequate safeguards to protect the First District's financial health, which is so vital to the farmer-borrowers of our region. Assessments by the newly formed Capital Corporation could result in a serious erosion of earned capital in our district. The absence of adequate safeguards against this could lead to crippling interest rate increases not only for our farmer-borrowers, but also for all other agricultural borrowers; a potential inability to service new farm borrowing needs; and a severely diminished ability to withstand a serious downturn in the agricultural economy of our region.

In addition, unrestricted pooling requirements create a strong disincentive for farm credit institutions to maintain earned capital and adequate loss reserves and could unwisely reward future imprudent management.

It has been argued that pooling of resources without adequate safeguards need not result in increased costs to borrowers, only in increased operating losses to farm credit institutions. This argument is based on the faulty assumption that the system has idle uninvested funds which can be made readily available to offset system losses without financial consequences. In fact, the transfer of resources will necessitate increased borrowing, the costs of which must ultimately be borne by farmer-borrowers who are also our shareholders.

We urge the Committee to adopt a specific limitation on borrowers' contributions to ailing institutions through the use of a ceiling on interest rate increases of 0.5 percent. This would allow equitable burden sharing in any pooling arrangement while maintaining the basic financial soundness and incentives for good management of contributing institutions.

We recognize and support the need for a more effective mechanism to pool system resources to aid troubled institutions. However, neither an equitable burden sharing arrangement such as the one we have suggested nor the mechanisms proposed in H.R. 3279 would obviate the need for some form of federal assistance to the farm credit system. We totally reject the concept that the entire system's financial stability be undermined in a self-help effort before federal assistance is rendered.

We believe there are other issues presented in H.R. 3792 which merit this Committee's further consideration. Farmer contributions to the Capital Corporation should take the form of an investment in the Capital Corporation in order to ensure that the farmer-borrowers' earned interest in the System is ultimately repaid. Finally, we believe that the Capital Corporation's board of directors must contain System members drawn from districts where all banks are contributors, and that they should be elected by the Farm Credit System. Should the federal government provide assistance, the System should nominate Capital Corporation board members and they should be approved by the FCA.

We stand ready to work with you and your colleagues in devising legislation that will strengthen the Farm Credit System. We would appreciate your inserting this statement in the record of the Committee's hearing.

Sincerely,

Robert Jensen
Robert Jensen
Chairman, Springfield
District Farm Credit
Board

Howell Hughes
Howell Hughes
President, Springfield
District Farm Credit
Board

AMERICAN
BANKERS
ASSOCIATION

1120 Connecticut Avenue, N.W.
Washington, D.C.
20036

DIRECTOR LEGISLATIVE OPERATIONS
AND SENIOR LEGISLATIVE COUNSEL
J. Denis O'Toole
202/467-6655

December 9, 1985

Honorable Ed Jones
Subcommittee on Conservation, Credit
and Rural Development
1301 Longworth House Office Building
Washington, DC 20515

Dear Mr. Chairman:

Thank you for the opportunity to submit for the record the American Bankers Association's testimony on H.R. 3792 which concerns the Farm Credit System (FCS).

First, as stated October 30 before your committee in our testimony on the subject of agricultural credit problems, the ABA objects to legislation that addresses only the difficulties of the Farm Credit System and its borrowers. Agricultural banks and their borrowers are facing the same economic situation as the FCS, and the bank's borrowers should be treated equitably.

Second, ABA has concerns about the potential power of the Capital Corporation proposed in H.R. 3792. The ABA's concerns about the proposed Capital Corporation stem from our belief that it is in the national interest to keep separate the short-term and the long-term aspects of Farm Credit System legislation. As stated in our written testimony of October 30, the short-term problem facing the Congress involves solvency of the System. The long-term problem concerns the appropriate role for the FCS in agricultural finance in the future.

To establish this new Capital Corporation and give it broad powers to pool System resources, warehouse loans, affect loan policies, establish branch offices and not to limit the time period or purposes for this Corporation's existence creates the potential of a very strong central entity for this decentralized, cooperative system. ABA believes that such an entity can lead a strong, aggressive, federally-assisted FCS into much more direct competition with commercial banks once the current crisis is over. ABA does not believe that a cooperative financial institution with a cooperative's tax benefits, a quasi-governmental agency's privileged access to the credit markets, and Federal assistance to deal with the same agricultural economy commercial banks are facing should be granted this centralized power. The Capital Corporation should be a limited, special purpose entity designed only to address the FCS's current financial problems.

To circumscribe the Capital Corporation's future potential for central power, ABA proposes:

1) a sunset provision for the Capital Corporation;

2) carefully structured legislative authority that targets and limits the Capital Corporation's activities to addressing the short-term financial problems of the FCS;

3) a requirement that the pooled FCS assets be returned to the financially strong districts from which the resources are taken, once the System returns to financial health;

4) a representative of the commercial banking industry on the Capital Corporation's board, since it is a special purpose corporation that may serve as the conduit for Federal assistance;

5) careful attention to the statutory relationships between the proposed Capital Corporation and existing FCS committees and service corporations (i.e., Farm Credit Corporation of America) to guarantee that the Capital Corporation cannot become a much stronger central entity in the future.

Mr. Chairman, thank you again for the opportunity to present our views.

Sincerely,

Denis O'Toole

J. Denis O'Toole

I

99TH CONGRESS
1ST SESSION

H. R. 3792

To amend the Farm Credit Act of 1971, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

NOVEMBER 20, 1985

Mr. DE LA GARZA (for himself, Mr. MADIGAN, Mr. JONES of Tennessee, and Mr. COLEMAN of Missouri) introduced the following bill; which was referred to the Committee on Agriculture

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A BILL

To amend the Farm Credit Act of 1971, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Farm Credit Act Amendments of 1985".

TITLE I—PROVISIONS TO STRENGTHEN THE OPERATION OF FARM CREDIT SYSTEM LENDING INSTITUTIONS

CAPITAL AND FINANCING

SEC. 101. Part A of title IV of the Farm Credit Act of 1971 is amended by—

(1) amending section 4.0 to read as follows:

"SEC. 4.0. REVOLVING FUNDS; INVESTMENTS.—The revolving fund established by Public Law 87-343, 75 Stat. 758, as amended, and the revolving fund established by Public Law 87-494, 76 Stat. 109, as amended, and continued by Public Law 96-592, shall be merged and shall be available to the Farm Credit Administration for the purchase, on behalf of the United States, of capital stock of the Farm Credit System Capital Corporation chartered under part D1 of title IV of this Act. The Farm Credit Administration may make such purchases of stock as the Farm Credit Administration determines, in its discretion, are necessary to achieve the purposes of this Act.";

(2) striking out section 4.1;

(3) in section 4.3, striking out subsection (a) and redesignating subsection (b) as subsection (c) and inserting new subsections (a) and (b) as follows:

"SEC. 4.3. CAPITAL ADEQUACY OF BANKS AND ASSOCIATIONS.—(a) The Farm Credit Administration shall cause System institutions to achieve and maintain adequate capital by establishing minimum levels of capital for such System institutions and by using such other methods as the Farm Credit Administration deems appropriate. The Farm Credit Administration may establish such minimum level of capital for a System institution as the Farm Credit Administration, in its discretion, deems to be necessary or appropriate in light of the particular circumstances of the System institution.

"(b)(1) Failure of a System institution to maintain capital at or above its minimum level as established under subsection (a) may be deemed by the Farm Credit Administration, in its discretion, to constitute an unsafe and unsound practice within the meaning of this Act.

"(2)(A) In addition to, or in lieu of, any other action authorized by law, including paragraph (1), the Farm Credit Administration may issue a directive to a System institution that fails to maintain capital at or above its required level as established under subsection (a). Such directive may require the System institution to submit and adhere to a plan acceptable to the Farm Credit Administration describing the means and timing by which the System institution shall achieve its required capital level, but may not require merger or consolidation without a majority vote of the voting stockholders or the contributors to the guaranty fund of the institution.

"(B) Any directive issued under this paragraph, including plans submitted pursuant thereto, shall be enforceable under the provisions of section 5.31 of this Act to the same extent as an effective and outstanding order issued under section 5.25 of this Act that has become final.

"(3) The Farm Credit Administration may consider such System institution's progress in adhering to any plan required under paragraph (2) whenever such System institution, or an affiliate thereof, seeks the requisite approval of the Farm Credit Administration for any proposal that would divert earnings, diminish capital, or otherwise impede such System institution's progress in achieving its minimum capital level. The Farm Credit Administration may deny such approval where it determines that such proposal would adversely affect the ability of the system institution to comply with such plan."; and

(4) in section 4.4—

(A) redesignating subsection (c) as subsection (d); and

(B) inserting, after subsection (b), the following:

"(c) For purposes of this part, the term 'bank' shall include the Farm Credit System Capital Corporation chartered under part D1 of this title.";

APPOINTMENT OF CONSERVATOR OR RECEIVER

SEC. 102. Section 4.12 of the Farm Credit Act of 1971 is amended by striking out subsection (b) and inserting in lieu thereof the following:

"(b) The Farm Credit Administration may appoint a conservator or receiver for any System institution on the determination by the Farm Credit Administration that one or more of the following exists, or is occurring, with respect to the institution: (1) insolvency in that the assets of the institution are less than its obligations to its creditors and others, including its members; (2) substantial dissipation of assets or earnings due to any violation of law, rules, or regulations, or to any unsafe or unsound practice; (3) an unsafe or unsound condition to transact business; (4) willful violation of a cease-and-desist order that has become final; (5) concealment of books, papers, records, or assets of the institution or refusal to submit books, papers, records, or other material relating to the affairs of the institutions for inspection to any examiner or to any lawful agent of the Farm Credit Administration. The Farm Credit Administration shall have exclusive power and jurisdiction to appoint a conservator or receiver. If the Farm Credit Administration determines that a ground for the appointment of a conservator or receiver as herein provided exists, the Farm Credit Administration may appoint ex parte and without notice a conservator or receiver for the institution. In the event of such appointment, the institution, within thirty days thereafter, may bring an action in the United States district court for the judicial district in which the home office of such institution is located, or in the United States District Court for the District of Columbia, for an order requiring the Farm Credit Administration to remove such conservator or receiver, and the court, shall on the merits, dismiss such action or direct the Farm Credit Administration to remove such conservator or receiver. On the commencement of such an action, the court having jurisdiction of any other action or enforcement proceeding authorized under this Act to which the institution is a party shall stay such action or proceeding during the pendency of the action for removal of the conservator or receiver.".

FARM CREDIT SYSTEM CAPITAL CORPORATION

SEC. 103. Title IV of the Farm Credit Act of 1971 is amended by inserting, after section 4.28, the following:

"PART D1—FARM CREDIT SYSTEM CAPITAL CORPORATION

"SEC. 4.28A. EXISTENCE OF CORPORATION.—The Farm Credit Administration, not later than 60 days after enactment of the Farm Credit Act Amendments of 1985, shall (1) charter the Farm Credit System Capital Corporation (referred to in this part as 'the Capital Corporation'), which, subject to the provisions of this part and the regulations of the Farm Credit Administration, shall be a federally chartered instrumentality of the United States and an institution of the Farm Credit System, and (2) revoke the charter for the Farm Credit System Capital Corporation issued under part D of this title.

"SEC. 4.28B. PURPOSES.—The Capital Corporation shall—

"(1) carry out a program of financial assistance among institutions of the Farm Credit System;

"(2) acquire from other Farm Credit System institutions and participate with such institutions in nonperforming assets of such institutions;

"(3) hold, restructure, collect, and otherwise administer nonperforming assets acquired from or participated in with other Farm Credit System institutions;

"(4) provide technical assistance and related services to other Farm Credit System institutions in connection with the administration of their loan portfolios;

"(5) provide assistance and related services to Farm Credit System institutions to assist them in restructuring or refinancing loans of their member-borrowers; and

"(6) receive and administer financial assistance for Farm Credit System institutions that originates outside of the Farm Credit System.

"SEC. 4.28C. BOARD OF DIRECTORS.—The Capital Corporation shall be governed by a board of directors composed of five members appointed by the Chairman of the Farm Credit Administration Board. Three of such members shall be appointed from among the elected members of the farm credit district boards established under title V of this Act and two of such members shall be individuals representing the public interest who are not members of such boards, nor directors, officers, or employees of any institution of the

Farm Credit System. The term of office of the directors of the Capital Corporation shall be three years, except that the terms of office of three of the members first appointed under this section shall expire, one on the expiration of one year after the date of appointment and two on the expiration of two years after the date of appointment, and members may continue to serve until their successors are duly appointed. Members of the board may be reappointed for new terms. Vacancies on the board shall be filled by like appointment.

"SEC. 4.28D. OFFICERS OF THE BOARD.—The Chairman of the Farm Credit Administration Board annually shall designate a member of the board of directors of the Capital Corporation as Chairman of the board. The board of directors of the Capital Corporation annually shall elect from among its members a vice chairman and select a secretary, who need not be a member of the board.

"SEC. 4.28E. COMPENSATION OF BOARD MEMBERS.—Members of the board of directors of the Capital Corporation shall receive compensation, including reasonable allowances for necessary expenses, in attending meetings of the board. The compensation shall not be in excess of the level set by the Farm Credit Administration.

"SEC. 4.28F. BOARD PROCEDURES.—The board of directors of the Capital Corporation shall adopt such rules as it may deem appropriate for the transaction of its business and shall keep permanent and accurate records and minutes of its acts and proceedings.

"SEC. 4.28G. CHIEF EXECUTIVE OFFICER OF THE CORPORATION.—The chief executive officer of the Capital Corporation shall be selected by the board of directors of the Capital Corporation, subject to the approval of the Farm Credit Administration, and shall serve at the pleasure of the board.

"SEC. 4.28H. GENERAL CORPORATE POWERS.—(a) The Capital Corporation shall be a body corporate and, subject to regulation by the Farm Credit Administration, shall have the power to—

"(1) operate under the direction of its board of directors;

"(2) adopt, alter, and use a corporate seal, which shall be judicially noted;

"(3) provide for one or more vice presidents, a secretary, a treasurer, and such other officers, employees and agents, as may be necessary, define their duties, and require surety bonds or make other provisions against losses occasioned by acts of such persons;

"(4) prescribe by its board of directors its bylaws, not inconsistent with law, which shall provide for the classes of its stock and the manner in which its stock shall be issued, transferred, and retired; the manner in which its officers, employees, and agents are selected; its property is acquired, held, and transferred; its loans, commitments, and other financial assistance are made; its general business is conducted; and the privileges granted by its bylaws are exercised and enjoyed;

"(5) enter into contracts and make advance, progress, or other payments with respect to such contracts;

"(6) contract with System institutions for local administration, servicing, and restructuring of loan and loan-related assets and management of acquired properties of the Corporation;

"(7) sue and be sued in its corporate name and complain and defend, in any court of competent jurisdiction, State or Federal;

"(8) acquire, hold, lease, mortgage, or dispose of, at public or private sale, real and personal property, and sell or exchange any securities or obligations, and otherwise exercise all the usual incidents of ownership of property necessary and convenient to its business;

"(9) obtain insurance against loss in connection with property and other assets;

"(10) modify or consent to modification with respect to the rate of interest, time of payment of any installment of principal or interest, security, or any other term of any contract or agreement to which it is a party or in which it has an interest under this Act;

"(11) in accordance with the provisions of this part, borrow money on its own individual responsibility;

"(12) join with Farm Credit System banks in the issuance of System wide notes, bonds, debentures, and other similar obligations under section 4.2(d) of this Act, or assume liability with respect to outstanding System wide obligations, and, if it satisfies the requirements applicable to banks under section 4.3 of this Act, it shall be jointly and severally liable with the System banks for the payment of principal and interest on such obligations, and pay on such obligations any sums as may be called on by the Farm Credit Administration to make payments of principal or interest that any bank or banks primarily liable therefor are unable to make;

"(13) require other institutions of the Farm Credit System, through purchase of stock in, or obligations of, the Capital Corporation, assessments, or other means, to make funds available to the Capital Corporation to enable it to make financial assistance available to institutions of the Farm Credit System as provided in paragraph (15). The guidelines to be used by the Capital

Corporation in obtaining funds from other institutions of the Farm Credit System for the purpose of aggregating resources to assist System institutions, to the extent practicable, shall give priority to obtaining funds through the use of transactions that require the Capital Corporation, on reasonable terms, to repay the contributed funds from surpluses accumulated by the Capital Corporation, and otherwise shall be in conformity with regulations issued by the Farm Credit Administration;

"(14)(A) issue regulations that establish standards to ensure that, to the maximum extent practicable, and consistent with sound business practices, the available capital of System institutions (other than stock held by borrowers) is devoted to providing financial assistance to those institutions of the Farm Credit System eligible therefor;

"(B) provide for regulatory measures that ensure that Farm Credit System institutions comply with directives of the Capital Corporation issued under this paragraph, without imperiling the financial viability of any such institution as would likely preclude such institution from making credit available to eligible borrowers on reasonable terms or meeting its financial obligations;

other term of any contract or agreement to which it is a party or in which it has an interest under this Act;

"(11) in accordance with the provisions of this part, borrow money on its own individual responsibility;

"(12) join with Farm Credit System banks in the issuance of System wide notes, bonds, debentures, and other similar obligations under section 4.2(d) of this Act, or assume liability with respect to outstanding System wide obligations, and, if it satisfies the requirements applicable to banks under section 4.3 of this Act, it shall be jointly and severally liable with the System banks for the payment of principal and interest on such obligations, and pay on such obligations any sums as may be called on by the Farm Credit Administration to make payments of principal or interest that any bank or banks primarily liable therefor are unable to make;

"(13) require other institutions of the Farm Credit System, through purchase of stock in, or obligations of, the Capital Corporation, assessments, or other means, to make funds available to the Capital Corporation to enable it to make financial assistance available to institutions of the Farm Credit System as provided in paragraph (15). The guidelines to be used by the Capital

"(15) make financial assistance available, in the form of purchases of stock, loans, or contributions under such terms and conditions as the Capital Corporation may establish under regulations of the Farm Credit Administration, to Farm Credit System institutions that establish, on the basis of information satisfactory to the Capital Corporation, that, in the absence of such assistance, they could no longer continue to operate on a viable basis, make credit available to eligible borrowers on reasonable terms, and meet their financial obligations;

"(16) purchase from any other System institution, at current value, on request of such institution, loans that have been placed in nonaccrual status and assets in the account for acquired properties. For purposes of this paragraph, the classification of loans and assets and their value shall be the classification and value as disclosed in the most recent examination of such institution conducted by or adopted by the Farm Credit Administration;

"(17) require System institutions to sell to the Capital Corporation loans and assets described in paragraph (16) as a condition to receiving financial assistance from the Capital Corporation;

"(18) exercise all the rights and privileges of any System institution with respect to any loan in which it has participated, including the adjustment of interest rates, compromise of indebtedness, waiver of default, and other such rights and privileges;

"(19) assume debt from System institutions or interests therein, or other liabilities, from System institutions in connection with the acquisition of loans or interests therein or other assets from such institutions;

"(20) refinance, reamortize, or compromise indebtedness, and otherwise provide debt adjustment assistance, with respect to any loan to a borrower of a System institution purchased by the Capital Corporation under paragraph (16), and, after a determination by the Capital Corporation that the borrower could not reasonably be anticipated to meet loan servicing charges under a refinanced, reamortized, or otherwise restructured loan under reasonable terms and conditions, liquidate any such loan;

"(21) establish one or more branch offices as from time to time may be authorized by the board of directors;

"(22) adopt a salary scale for officers and employees of the Capital Corporation, in accordance with the directives of the board of directors, without regard to the provisions of chapter 51 and subchapter III of chapter 53 of title 5 relating to classification and General Schedule pay rates; and

"(23) deposit its securities and its current funds with any member of the Federal Reserve System or any insured State nonmember bank as defined in section 2 of the Federal Deposit Insurance Act and pay fees therefor and receive interest thereon as may be agreed.

The Capital Corporation shall have such other incidental powers as are necessary or expedient to carry out its powers, duties, and functions in accordance with this Act.

"(b) Officers or employees of the Capital Corporation, like other Farm Credit System employees, shall not be considered officers or employees of the Federal Government. Funds held by the Capital Corporation shall not be construed to be Government funds or appropriated moneys.

SEC. 4.28I. SUCCESSION OF THE CORPORATION.—On the issuance by the Farm Credit Administration of the new charter for the Capital Corporation under this part, the Capital Corporation shall succeed to, be liable for, and assume all debts, obligations, contracts, and other liabilities of the Farm Credit System Capital Corporation chartered under part D of this title (referred to in this section as 'the predecessor corporation'), matured or unmatured, accrued, absolute, contingent or otherwise, and whether or not reflected or reserved against on balance sheets, books of account, or records of the predecessor corporation. The stock of the predecessor corporation shall be converted into stock of the corporation chartered under this part. The existing contractual obligations, security instruments, and title instruments of the predecessor corporation shall, by operation of law and without any further action by the Farm Credit Administration, the predecessor corporation, or any court, become and be converted into obligations, entitlements, and instruments of the Capital Corporation chartered under this part. To the extent that, on the extinguishing of liabilities assumed by the Capital Corporation under this section, and full performance or other final disposition of contract obligations under contracts assumed by the Capital Corporation under this section, there remain surplus funds attributable to such obligations or contracts, the Capital Corporation shall distribute such surplus funds among the System institutions that contributed funds to the predecessor corporation on the basis of the relative amount of funds so contributed by each institution.

"SEC. 4.28J. LIMITATION OF POWERS.—The powers of the Capital Corporation under this part shall be exercised only for the purposes specified in this part and shall not be exercised in a manner that would result in the Capital Corporation supplanting the Farm Credit System institutions operating under titles I through III of this Act as the primary providers of credit and other financial services to farmers, ranchers, and their cooperatives.

"SEC. 4.28K. AUTHORITY OF THE SECRETARY OF THE TREASURY.—(a) On certification by the Farm Credit Administration that (1) the Farm Credit System is in need of financial assistance to address financial stress of System institutions, (2) the System has committed its available capital surplus and reserves to address such financial stress of System institutions, and (3) the System has used such capital surplus and reserves to the extent that further contributions from, or losses incurred by, System institutions likely will preclude such institutions from making credit available to eligible borrowers on reasonable terms, the Secretary of the Treasury in the Secretary's discretion, may purchase any obligations issued by the Capitol Corporation under this part, as heretofore, now, or hereafter in force; and for such purpose the Secretary of the Treasury may use as a public-debt transaction the proceeds of the sale of any securities hereafter issued under the Second Liberty Bond Act, as now or hereafter in force, and the purposes for which securities may be issued under the Second Liberty Bond Act, as now or hereafter in force, are extended to include such purchases. The Secretary of the Treasury, at any time, may sell, on such terms and conditions and at such price or prices as the Secretary shall determine, any of the obligations acquired by the Secretary under this section. All redemptions, purchases, and sales by the Secretary of the Treasury of such obligations under this section shall be treated as public-debt transactions of the United States. Each purchase of obligations by the Secretary of the Treasury under this subsection shall be on terms and conditions as shall be determined by the Secretary of the Treasury and shall bear such rate of interest as may be determined by the Secretary of the Treasury, taking into consideration the current average market yield for the month preceding the month of such purchase on outstanding marketable obligations of the United States.

"(b) The Farm Credit Administration promptly shall submit a copy of any certification made under subsection (a) to Congress, and the Secretary of the Treasury shall, not later than forty-five days after such certification is made, make known the Secretary's decision as to exercising the authority under subsection (a).".

"SEC. 4.28L. INITIAL CAPITALIZATION.—The Farm Credit Administration shall provide for the initial capitalization of the Capital Corporation by requiring institutions of the System to contribute capital to the Capital Corporation in such amounts and under such terms and conditions as the Farm Credit Administration, in consultation with System institutions, may prescribe.".

CONFORMING AMENDMENT

"SEC. 204. Title IV of the Farm Credit Act of 1971 is further amended by inserting, before section 4.2, the following:

"SEC. 4.1. REQUIREMENTS TO PURCHASE STOCK AND PAY ASSESSMENTS AND CONTRIBUTE CAPITAL TO CAPITAL CORPORATION.—The Federal land banks, the Federal intermediate credit banks, the banks for cooperatives, the Federal land bank associations, and the production credit associations shall purchase stock in, or obligations of, the Capital Corporation, pay assessments, make capital contributions, and take such other related actions as required by the Capital Corporation in the exercise of its powers under this Part. Any payment for retirement of stock so purchased, or repayment of obligations so purchased by the Capital Corporation shall be distributed among all holders of such stock or obligations on the basis of the face value of the stock or obligations held by each such holder at the time of the distribution.".

TITLE II—REGULATION OF THE FARM CREDIT SYSTEM

RESTRUCTURE OF THE FARM CREDIT ADMINISTRATION

"SEC. 201. Part B of title V of the Farm Credit Act of 1971 is amended by—

(1) amending sections 5.7 through 5.12 to read as follows:

SEC. 5.7. THE FARM CREDIT ADMINISTRATION.—The Farm Credit Administration shall be an independent agency in the executive branch of the Government. It shall be composed of the Farm Credit Administration Board and such other personnel as are employed in carrying out the functions, powers, and duties vested in the Farm Credit Administration by this Act.

"SEC. 5.8. THE FARM CREDIT ADMINISTRATION BOARD; APPOINTMENT; TERM OF OFFICE; ORGANIZATION AND COMPENSATION.—(a) The management of the Farm Credit Administration shall be vested in a Farm Credit Administration Board (referred to in this part as 'the Board'). The Board shall consist of five members who shall be citizens of the United States and broadly representative of the public interest. Members of the Board shall be appointed by the President, by and with the advice and consent of the Senate. Not more than three members of the Board shall be members of the same political party. Of the persons thus appointed, one shall be designated by the President to serve as Chairman of the Board for the duration of the member's term. The members of the Board shall be ineligible during the time they are in office and for two years thereafter to hold any office, position, or employment in any institution of the Farm Credit System.

"(b) The term of office of each member of the Board shall be six years, except that the terms of the four members, other than the Chairman, first appointed under subsection (a) shall expire, two on the expiration of two years after the date of appointment, and two on the expiration of four years after the date of appointment. Members of the Board shall not be appointed to succeed themselves, except that the members first appointed under subsection (a) for a term of less than six years may be reappointed for a full six-year term and members appointed to fill unexpired terms of three years or less may be reappointed for a full six-year term. Any vacancy shall be filled for the unexpired term on like appointment. Any member of the Board shall continue to serve as such after the expiration of the member's term until a successor has been appointed and qualified.

"(c) Each member of the Board, within fifteen days after notice of appointment, shall subscribe to the oath of office. The Board may transact business if a vacancy exists, provided a quorum is present. A quorum shall consist of three members of the Board. The Board shall hold at least one meeting each month and such additional meetings at such times and places as it may fix and determine. Such meetings shall be held on the call of the Chairman or any two Board members. The Board shall adopt such rules as it deems appropriate for the transaction of its business and shall keep permanent and accurate records and minutes of its acts and proceedings.

"(d) The members of the Board shall devote their full time and attention to the business of the Board. The Chairman of the Board shall receive compensation at the rate prescribed for level III of the Executive Schedule under section 5314 of title 5 of the United States Code. Each of the other members of the Board shall receive compensation at the rate prescribed for level IV of the Executive Schedule under section 5315 of title 5 of the United States Code. Each member of the Board shall be reimbursed for necessary travel, subsistence, and other expenses in the discharge of the member's official duties without regard to other laws with respect to allowance for travel and subsistence of officers and employees of the United States. The provisions of this subsection shall be subject to the provisions of section 5.11 of this Act.

"SEC. 5.9. POWERS OF THE BOARD; CIVIL PROCEEDINGS.—The Board shall manage and administer, and establish policies for, the Farm Credit Administration. It—

"(1) shall approve the rules and regulations for the implementation of this Act not inconsistent with its provisions;

"(2) shall provide for the examination of the condition of, and general regulation of the performance of the powers, functions, and duties vested in, each institution of the Farm Credit System;

"(3) shall provide for the performance of all the powers and duties vested in the Farm Credit Administration; and

"(4) may require such reports as it deems necessary from the institutions of the Farm Credit System.

"SEC. 5.10. CHAIRMAN; RESPONSIBILITIES; GOVERNING STANDARDS.—(a) The Chairman of the Board shall be the executive officer of the Board and the chief executive officer of the Farm Credit Administration. The Chairman shall be responsible for directing the implementation of the policies and regulations adopted by the Board and the execution of all of the administrative functions and duties of the Farm Credit Administration. The Chairman shall be the spokesman for the Board and the Farm Credit Administration and shall represent the Board and the Farm Credit Administration in their official relations within the Government. Under policies adopted by the Board, the Chairman shall consult on a regular basis with the Secretary of the Treasury in connection with the exercise by the System of the powers conferred under section 4.2 of this Act, and with the Board of Governors of the Federal Reserve System in connection with establish and fix the powers and the duties of such divisions or other units as the Chairman may deem necessary to the efficient functioning of the Farm Credit Administration and the successful execution of the powers and duties vested in the Board and the Farm Credit Administration. The Chairman of the Board shall appoint such personnel as may be necessary to carry out the functions of the Farm Credit Administration. Officers and employees of the Farm Credit Administration shall be subject to the Ethics in Government Act of 1978 and shall be considered officers or employees of the United States for the purposes of sections 201 through 203, and sections 205 through 209, of title 18 of the United States Code. Officers and employees of the Farm Credit Administration shall be subject to section 5373 of title 5 of the United States Code. The powers of the Chairman as chief executive officer of the Farm Credit Administration may be exercised and performed by the Chairman through such other officers and employees of the Farm Credit Administration as the Chairman shall designate. The operations of the Farm Credit Administration, and the salaries of members of the Board and employees of the Administration, shall be funded and paid for from the fund created under section 5.15 of this Act.

"SEC. 5.12. ADVISORY COMMITTEES.—The Chairman of the Board may establish one or more advisory committees in accordance with the Federal Advisory Committee Act and may appoint to such committee or committees individuals who are members of the Federal Farm Credit Board when such Board is terminated by the Farm Credit Act Amendments of 1985.";

(2) striking out section 5.13;

(3) redesignating section 5.14 as section 5.13, and, in section 5.13, as so redesignated, striking out "Governor" and inserting in lieu thereof "Board";

(4) redesignating section 5.15 as section 5.14, and, in the second sentence of section 5.14, as so redesignated, striking out "section 5.16(b)" and "section 5.16(a)" and inserting in lieu thereof "section 5.15(b)" and "section 5.15(a)", respectively;

(5) redesignating section 5.16 as section 5.15;

(6) redesignating section 5.17 as section 5.16, and, in the section 5.16, as so redesignated—

(A) striking out "section 5.15" in the first sentence and inserting in lieu thereof "section 5.14";

(B) striking out "Federal Farm Credit" in clause (2) of the first sentence; and

(C) in the fourth sentence, striking out "section 5.16" and inserting in lieu thereof "section 5.15"; and

(7) redesignating section 5.18 as section 5.17 and amending subsection (a) thereof to read as follows:

"(a) The Farm Credit Administration shall have the following powers, functions, and responsibilities in connection with the institutions of the Farm Credit System and the administration of this Act:

"(1) Modify the boundaries of farm credit districts, with due regard for the farm credit needs of the country, as approved by the Board, with the concurrence of the district boards involved.

"(2) Where necessary or appropriate to carry out the policy and objectives of this Act, issue and amend or modify Federal charters of institutions of the System; approve change in names of banks operating under this Act; approve the merger of districts when agreed to by the boards of the districts involved and by a majority vote of the voting stockholders and contributors to the guaranty funds of each bank for each of such districts, voting in the same manner as is provided in section 4.10 of this Act; approve mergers of banks operating under the same title of this Act, merger of Federal land bank associations, merger of production credit associations, and the consolidation or division of the territories that they serve when agreed to by a majority vote of the voting stockholders or contributors to the guaranty fund of the institutions involved; and approve consolidations of boards of directors or management agreements when agreed to by a majority vote of the voting stockholders or contributors to the guaranty fund of the institutions involved.

"(3) Make annual reports directly to Congress on the condition of the System and its institutions, based on the examinations carried out under section 5.18 of this Act, and on the manner and extent to which the purposes and objectives of this Act are being carried out and, from time to time, recommend directly legislative changes. The annual reports shall include a summary and analysis of the reports submitted to the Farm Credit Administration by the Federal land banks and Federal intermediate credit banks under section 4.19(b) of this Act relating to programs for serving young, beginning, and small farmers and ranchers.

"(4) Approve the issuance of obligations of the System under sections 4.2 (c) and (d) of this Act for the purpose of funding the authorized operations of the institutions of the System, and prescribe collateral therefor.

"(5) Grant approvals provided for under this Act either on a case-by-case basis or through regulations that confer approval on actions of Farm Credit System institutions that meet standards and criteria established by the Farm Credit Administration, including standards and criteria with respect to (A) interest rates on obligations of Farm Credit System institutions and on loans made or discounted by such institutions, and (B) the payment of dividends or patronage refunds by Farm Credit System institutions.

"(6) Established standards for the System institutions with respect to loan security requirements and the borrowing, repayment, and transfer of funds and equities between institutions of the System.

"(7) Conduct loan and collateral security review.

"(8) Make investments in stock of the institutions of the System as provided in section 4.0 of this Act out of the revolving fund, and require the retirement of such stock.

"(9) Regulate the preparation by System institutions and the dissemination to stockholders and investors of information on the financial condition and operations of such institutions.

"(10) Prescribe rules and regulations necessary or appropriate for carrying out the provisions of this Act.

"(11) Exercise the powers of the Farm Credit Administration under part C of this title for the purpose of ensuring the safety and soundness of System institutions.

"(12) Exercise such incidental powers as may be necessary or appropriate to fulfill its duties and carry out the purposes of this Act.

"(13) Sue and be sued, complain and defend in any court of law or equity, State of Federal. All suits of a civil nature at common law or in equity to which the Farm Credit Administration shall be a party shall be deemed to arise under the laws of the United States, and the United States district courts shall have original jurisdiction thereof, without regard to the amount of the controversy; and the Farm Credit Administration may, without bond or security, remove any such action, suit, or proceeding from a State court to the United States district court for the district or division embracing the place where the same is pending by following any procedure for removal now or hereafter in effect. Service of process on the Farm Credit Administration shall be in accordance with provisions of title 28 of the United States Code and rules adopted under title 28 for suits in which an agency of the United States is a party. The Farm Credit Administration shall designate an agent at its principal office to accept service of process.".

DELEGATIONS

SEC. 202. (a) Section 5.19 of the Farm Credit Act of 1971 is repealed.

(b) Part B of title V of the Farm Credit Act of 1971 is further amended by inserting, after section 5.17, as added by section 201 of this title, the following:

"SEC. 5.18. PRIOR DELEGATIONS.—Any delegations by the Farm Credit Administration and redelegations thereof made in accordance with section 5.19 of the Farm Credit Act of 1971 as in effect prior to the effective date of the Farm Credit Act Amendments of 1985 may continue in full force and effect, at the discretion of the Farm Credit Administration, for the period ending twelve months after the date of enactment of such Act.".

FARM CREDIT ADMINISTRATION EXAMINATIONS; CONFORMING AMENDMENT

SEC. 203. (a) Section 5.20 of the Farm Credit Act of 1971 is redesignated as section 5.19 and amended to read as follows:

"SEC. 5.19. EXAMINATIONS.—(a) Each institution of the System shall be examined by Farm Credit Administration examiners at such times as the Chairman of the Board may determine, but in no event less than once each year. Such examinations shall include, but are not limited to, an analysis of credit and collateral quality and capitalization of the institution, and appraisals of the effectiveness of the institution's management and application of policies governing the carrying out of this Act and regulations of the Farm Credit Administration and servicing all eligible borrowers. At the direction of the Chairman of the Board, Farm Credit Administration examiners also shall make examinations of the condition of any organization, other than national banks, to, for, or with which any institution of the System contemplates making a loan or discounting paper. For the purposes of this Act, examiners of the Farm Credit Administration shall be subject to the same requirements, responsibilities, and penalties as are applicable to examiners under the National Bank Act, the Federal Reserve Act, and Federal Deposit Insurance Act, and other provisions of law and shall have the same powers and privileges as are vested in such examiners by law.

"(b) Each institution of the System shall make and publish an annual report of condition as prescribed by the Farm Credit Administration. Each such report shall contain financial statements prepared in accordance with generally accepted accounting principles or with such additional standards or requirements as the Farm Credit Administration by regulation may prescribe if it determines that such standards or requirements are necessary to more accurately and adequately reflect the financial condition of such institution. Such financial statements of System institutions shall be audited by an independent public accountant.

"(c) The Farm Credit Administration may order to be published the report of examination of any System institution.

"(d) For purposes of this section, institutions of the System shall include the Capital Corporation.".

(b) Sections 5.21, 5.22, 5.23, 5.24, and 5.25 of the Farm Credit Act of 1971 are redesignated as sections 5.19, 5.20, 5.21, 5.22, 5.23, and 5.24, respectively.

ENFORCEMENT POWERS

SEC. 204. Title V of the Farm Credit Act of 1971 is amended by inserting, after section 5.24, as so redesignated by section 203(b), the following:

"PART C—ENFORCEMENT POWERS OF THE FARM CREDIT ADMINISTRATION

"SEC. 5.25. CEASE-AND-DESIST PROCEEDINGS.—(a)(1) The Farm Credit Administration may issue and serve a notice of charges on an institution of the Farm Credit System, or any director, officer, employee, or agent thereof, or other person participating in the conduct of the affairs of the institution, if the Farm Credit Administration has reasonable cause to believe that the institution or the person (A) is engaging in, has engaged in, or is about to engage in, an unsafe or unsound practice in conducting the business of the institution; or (B) is violating, has violated, or is about to violate, a law, rule, or regulation, or any condition imposed in writing by the Farm Credit Administration in connection with the Farm Credit Administration's regulation of the institution or any written agreement entered into with the Farm Credit Administration.

"(2) A notice issued and served under paragraph (1) shall contain a statement of the facts constituting the basis for the charges made therein against the institution or person. The notice shall fix a time and place for a hearing on the charges to determine whether an order to cease and desist from the violation or unsafe or unsound practice should be issued against the institution or person. The hearing shall be fixed for a date not earlier than thirty days nor later than sixty days after service of such notice unless an earlier or a later date is set by the Farm Credit Administration at the request of any party so served.

"(b) If an institution or person served by a notice under subsection (a) fails to appear at the hearing personally or by a duly authorized representative, such institution or person shall be deemed to have consented to the issuance of the cease-and-desist order. If consent is so deemed, or if the Farm Credit Administration finds on the record made at the hearing that any violation or unsafe or unsound practice specified in the notice of charges has been established, the Farm Credit Administration may issue and serve on the institution or person an order to cease and desist from the violation or practice. The order, by provisions that may be mandatory or otherwise, may require the institution or person to cease and desist from the same and take affirmative action to correct the conditions resulting from any such violation or practice.

"(c) An order issued under subsection (b) shall become effective at the end of thirty days after service on the institution or person to whom it is directed (except in the case of an order issued on consent, the order shall become effective at the time specified therein), and shall remain effective and enforceable as provided therein, except to the extent that it is stayed, modified, terminated, or set aside by action of the Farm Credit Administration or a reviewing court.

"SEC. 5.26. TEMPORARY CEASE AND DESIST ORDERS.—(a) Whenever the Farm Credit Administration determines that any violation or threatened violation, or unsafe or unsound practice, specified in the notice of charges issued and served on an institution of the Farm Credit System or any director, officer, employee, or agent thereof, or other person participating in the conduct of the affairs of the institution, under section 5.25 of this Act, or the continuation thereof, is likely to cause insolvency or substantial dissipation of assets or earnings of the institution, or is likely to seriously weaken the financial condition of the institution or otherwise seriously prejudice the interest of the stockholders of the institution prior to completion of the proceedings conducted under section 5.25, the Farm Credit Administration may issue a temporary order requiring the institution or person to cease and desist from any such violation or practice and to take affirmative action to prevent such insolvency, dissipation, condition or prejudice pending completion of such proceedings. Such order shall become effective on service on the institution or person and, unless set aside, limited, or suspended by a court in proceedings authorized by subsection (b), shall remain effective and enforceable pending the completion of the administrative proceedings under the notice and until such time as the Farm Credit Administration dismisses the charges specified in the notice, or if a cease and desist order is issued against the institution or person, until the effective date of such order.

"(b) Within ten days after an institution or person has been served with a temporary cease and desist order under subsection (a), the institution or person may apply to the United States district court for the district in which the principal office of the institution is located, or the United States District Court of the District of Columbia, for an injunction setting aside, limiting, or suspending the enforcement, operation, or effectiveness of such order pending the completion of the administrative proceeding under the notice of charges served on the institution or person under section 5.25, and such court shall have jurisdiction to issue such injunction.

"SEC. 5.27. ENFORCEMENT OF TEMPORARY CEASE AND DESIST ORDERS.—In the case of violation or threatened violation of, or failure to obey, a temporary cease and desist order issued under section 5.26, the Farm Credit Administration may apply to the United States district court for the district in which the principal office of the institution is located, for an injunction to enforce such order, and if the court determines that there has been such violatioin or threatened violation or failure to obey, it shall be the duty of the court to issue such injunction.

"SEC. 5.28. REMOVAL OR SUSPENSION OF DIRECTOR OR OFFICER.—(a) The Farm Credit Administration may serve on any director or officer of an institution of the Farm Credit System a written notice of its intention to remove such director or officer from office if the Farm Credit Administration has reasonable cause to believe that—

"(1) the director or officer has committed (A) any violation of law, rule, or regulation, or a cease and desist order that has become final; (B) has engaged or participated in any unsafe or unsound practice in connection with the management of the institution; or (C) has committed or engaged in any act, omission, or practice that constitutes a breach of such person's fiduciary duty as a director or officer; and

"(2)(A)(i) the institution has suffered or will probably suffer material financial loss or other damage, or the interest of its stockholders could be seriously prejudiced by reason of such violation or practice or breach of fiduciary duty; or (ii) the director or officer has received financial gain by reason of such violation or practice or breach of fiduciary duty; and (B) such violation or practice or breach of fiduciary duty is one that involves personal dishonesty on the part of the director or officer, or one that demonstrates a willful, grossly negligent, or continuing disregard for the safety or soundness of the institution.

"(b) The Farm Credit Administration may serve on any director or officer of an institution of the Farm Credit System a written notice of its intention to remove such director or officer from office if the Farm Credit Administration has reasonable cause to believe that the director or officer, by conduct or practice with respect to any institution of the System or other business entity that resulted in substantial financial loss or other damage, has evidenced either personal dishonesty or a willful, grossly negligent, or continuing disregard for the safety and soundness of the institution or entity, and has evidenced unfitness to continue as a director or officer.

"(c) The Farm Credit Administration may serve on any person participating in the conduct of the affairs of an institution of the Farm Credit System written notice of its intention to prohibit such person from further participation in the conduct of the affairs of the institution whenever the Farm Credit Administration has reasonable cause to believe that such person, by conduct or practice with respect to any institution of the Farm Credit System or other business entity that resulted in substantial financial loss or other damage, has evidenced either personal dishonesty or a willful, grossly negligent, or continuing disregard for the safety and soundness of the institution or entity, and has evidenced unfitness to participate in the conduct of the affairs of such institution.

"(d) If the Farm Credit Administration deems it necessary for the protection of the institution or the interests of the stockholders of the institution prior to completion of proceedings under subsection (a), (b), or (c), the Farm Credit Administration, by written notice served on a director, officer, or other person subject to such proceedings, may suspend such person from office or temporarily prohibit such person from further participation in the conduct of the affairs of the institution, as the case may be. Such suspension or temporary prohibition shall become effective on service of such notice, and unless stayed by a court in proceedings authorized by subsection (g), shall remain in effect pending the completion of the administrative proceedings under the notice served under subsection (a), (b), or (c) and until such time as the Farm Credit Administration dismisses the charges specified in such notice, or if an order of removal or prohibition is issued against the person, until the effective date of such order. A copy of any notice issued under this subsection shall be served on the institution concerned.

"(e) Any notice served on a person under subsection (a), (b), or (c) shall contain a statement of the facts constituting the grounds therefor and shall fix a time and place at which a hearing will be held thereon. Such hearing shall be fixed for a date not earlier than thirty days or later than sixty days after the day of service of such notice, unless an earlier or a later date is set by the Farm Credit Administration at the request of the person on whom the notice was served. If a person on whom the notice was served fails to appear at the hearing in person or by a duly authorized representative, such person shall be deemed to have consented to the issuance of an order of removal or prohibition. If consent is so deemed, or if the Farm Credit Administration finds on the record made at the hearing that any of the grounds specified in such notice have been established, the Farm Credit Administration may issue such orders of removal or suspension from office, or prohibition from participation in the conduct of the affairs of the institution, as it may deem appropriate. A copy of any order issued under this subsection shall be served upon the institution concerned.

"(f) An order issued under subsection (e) shall become effective at the end of thirty days after service on the person to whom it is directed (except in the case of an order issued on consent, such order shall become effective at the time specified therein). The order shall remain effective and enforceable except to the extent that it is stayed, modified, terminated, or set aside by action of the agency or a reviewing court.

"(g) Within ten days after a director, officer, or other person participating in the conduct of the affairs of an institution of the Farm Credit System has been served a notice under subsection (d), such person may apply to the United States district court for the district in which the principal office of the institution is located, or the United States District Court for the District of Columbia, for a stay of any suspension or temporary prohibition under the order pending the completion of the administrative proceedings under the notice served under subsection (a), (b), or (c), and such court shall have jurisdiction to stay any such suspension or prohibition.

"SEC. 5.29. SUSPENSION OR REMOVAL OF A DIRECTOR OR OFFICER CHARGED WITH A FELONY.—(a) Whenever any director or officer of an institution of the Farm

Credit System, or other person participating in the conduct of the affairs of such institution, is charged in any information, indictment, or complaint, authorized by a United States attorney, with the commission of or participation in a crime involving dishonesty or breach of trust that is punishable by imprisonment for a term exceeding one year under State or Federal law, the Farm Credit Administration, by written notice served upon the person, may suspend the person from office or temporarily prohibit the person from further participation in the conduct of the affairs of the institution if continued service or participation by the person poses a threat to the interest of the institution's stockholders or may threaten to impair public confidence in the institution. A copy of such notice shall also be served on the institution concerned. Such suspension or temporary prohibition shall be effective on service and shall remain effective and enforceable until the final disposition of such information, indictment, or complaint except to the extent that it is stayed, modified, or terminated by the Farm Credit Administration. If a judgment of conviction with respect to such crime is entered against the person, and at such time as such judgment is not subject to further appellate review, the Farm Credit Administration may issue and serve on the person an order removing the person from office, or prohibiting the person from further participation in the conduct of the affairs of the institution except with the consent of the Farm Credit Administration, if continued service or participation by the person may pose a threat to the interests of the institution's stockholders or may threaten to impair public confidence in the institution. Such order shall be effective on service and shall remain effective and enforceable except to the extent that it is stayed, modified, or terminated by the Farm Credit Administration. A copy of such order shall also be served upon the institution concerned. A finding of not guilty or other disposition of the charge shall not preclude the Farm Credit Administration from thereafter instituting proceedings to remove the director or officer from office or to prohibit the person from further participation in the conduct of the affairs of the institution under section 5.28 of this Act.

"(b) Within thirty days after service of any notice of suspension or temporary prohibition or any order of removal or prohibition issued under subsection (a), the person concerned may request in writing an opportunity to appear before the Farm Credit Administration to show that continued service to or participation in the conduct of the affairs of the institution by such individual does not, or is not likely to, pose a threat to the interests of the stockholders of the institution or threaten to impair public confidence in the institution. On receipt of any such request, the Farm Credit Administration shall fix a time (not more than thirty days after receipt of such request, unless extended at the request of the concerned person) and place at which the person may appear, personally or through counsel, before one or more designated employees of the Farm Credit Administration to submit written materials (or, at the discretion of the Farm Credit Administration, oral testimony) and oral argument. Within sixty days after such hearing, the Farm Credit Administration shall notify the person whether the suspension or temporary prohibition will be continued, terminated, or otherwise modified, or whether the order of removal or prohibition will be rescinded or otherwise modified. Such notification shall contain a statement of the basis for the Farm Credit Administration's decision, if adverse to the director, officer, or other person.

"SEC. 5.30. HEARINGS AND JUDICIAL REVIEW.—(a) Any hearing provided for in this part (except section 5.29) shall be held in the Federal judicial district in which the principal office of the System institution is located unless the person afforded the hearing consents to another place, and shall be conducted in accordance with the provisions of chapter 5 of title 5 of the United States Code. Such hearing shall be private unless the Farm Credit Administration, in its discretion, after fully considering the views of the person afforded the hearing, determines that a public hearing is necessary to protect the public interest. After such hearing, and within ninety days after the person has been notified that the case has been submitted by an administrative law judge to the Farm Credit Administration Board for final decision, the Farm Credit Administration Board shall (1) render a decision that includes the findings of fact on which it is based, and (2) issue and serve on each party to the proceeding an order or orders consistent with the provisions of this part. Judicial review of any such order shall be exclusive as provided in subsection (b). Unless a petition for review is timely filed in a court of appeals of the United States, as provided in subsection (b), and thereafter until the record in the proceeding has been filed as so provided, the Farm Credit Administration at any time, on such notice and in such manner as it shall deem proper, may modify, terminate, or set-aside any such order. On such filing of the record, the Farm Credit Administration may modify, terminate, or set aside any such order with permission of the court.

"(b) Any party to the proceedings under subsection (a), or any person required by an order issued under section 5.25(b) of this Act to cease and desist from any of the violations or practices stated therein, may obtain a review of any order served under subsection (a) by the filing in the court of appeals of the United States for the circuit in which the principal office of the institution is located, or in the United States Court of Appeals for the District of Columbia Circuit, within thirty days after the date of service of such order, a written petition praying that the order of the Farm Credit Administration be modified, terminated, or set-aside. A copy of such petition shall be transmitted forthwith by the clerk of the court to the Farm Credit Administration, and thereon the Farm Credit Administration shall file in the court the record in the proceeding, as provided in section 2112 of title 28 of the United States Code. On the filing of such petition, such court shall have exclusive jurisdiction to affirm, modify, terminate, or set-aside, in whole or in part, the order of the Farm Credit Administration. Review of such proceedings shall be had as provided in chapter 7 of title 5 of the United States Code. The judgment and decree of the court shall be final, except that the same shall be subject to review by the Supreme Court of the United States on certiorari, as provided in section 1254 of title 28 of the United States Code.

"(c) The commencement of proceedings for judicial review under subsection (b), unless specifically ordered by the court, shall not operate as a stay of any order issued by the Farm Credit Administration.

"SEC. 5.31. JURISDICTION AND ENFORCEMENT.—The Farm Credit Administration may apply to the United States district court, or the United States court of any territory, within the jurisdiction of which the principal office of the institution is located, for the enforcement of any effective and outstanding notice or order issued under this part, and such courts shall have jurisdiction and power to order and require compliance herewith. However, except as otherwise provided in this part, no cmurt shall have jurisdictimn to affect by injunction or otherwise the issuance or enforcement of any notice or order under this part, or to review, modify, suspend, terminate, or set aside any such notice or order.

"SEC. 5.32. PENALTY.—(a) Any System institution or any officer, director, employee, or agent thereof, or any person participating in the conduct of the affairs of such institution who violates any of the provisions of this Act or the terms of any order issued under section 5.25 or 5.26 of this Act that has become final, shall forfeit and pay a civil penalty of not more than $1,000 per day for each day during which such violation continues. The Farm Credit Administration, in its discretion, may compromise, modify, or remit any civil money penalty that is subject to imposition or has been imposed under this section. The penalty may be assessed and collected by the Farm Credit Administration by written notice.

"(b) In determining the amount of the penalty, the Farm Credit Administration shall take into account the appropriateness of the penalty with respect to the size of financial resources and good faith of the institution or person charged, the gravity of the violation, the history of any previous violations, and such other matters as justice may require.

"(c) the System institution or person assessed shall be afforded an opportunity for a hearing by the Farm Credit Administration on request made within ten days after issuance of the notice of assessment. In such hearing all issues shall be determined on the record under section 554 of title 5 of the United States Code. The agency determination shall be made by final order, which may be reviewed only as provided in subsection (d). If no hearing is requested as herein provided, the assessment shall constitute a final and unappealable order.

"(d) Any System institution or person against whom an order imposing a civil money penalty has been entered after a hearing under this section may obtain review by the United States court of appeals for the circuit in which the principal office of the System institution is located, or the United States Court of Appeals for the District of Columbia Circuit, by filing a notice of appeal in such court within twenty days after the service of such order, and simultaneously sending a copy of such notice by registered or certified mail to the Farm Credit Administration. The Farm Credit Administration shall promptly certify and file in such court the record on which the penalty was imposed, as provided in section 2112 of title 28 of the United States Code. The findings of the

Farm Credit Administration shall be set aside if found to be unsupported by substantial evidence, as provided by section 706(2)(E) of title 5 of the United States Code.

"(e) If any System institution or person fails to pay an assessment after it has become a final and unappealable order or after the court of appeals has entered final judgment in favor of the Farm Credit Administration, the Farm Credit Administration shall refer the matter to the Attorney General, who shall recover the amount assessed by action in the appropriate United States district court. In such action, the validity and appropriateness of the final order imposing the penalty shall not be subject to review.

"(f) All penalties collected under authority of this section shall be covered into the Treasury of the United States.

"SEC. 5.33. REPLACEMENT OR SUSPENDED OR REMOVED DIRECTORS.—If, at any time, because of the suspension or removal of one or more directors under section 5.28 or 5.29 of this Act, there shall be on the board of directors of a System institution less than a quorum of directors not so suspended or removed, the Chairman of the Farm Credit Administration Board shall appoint persons to serve temporarily as directors in their place and stead so as to establish a quorum of the Board pending any appeal of such removal until such time as those who have been removed are reinstated or their respective successors are duly elected and take office.

"SEC. 5.34. DEFINITIONS.—As used in this part—(a) the phrases 'cease and desist order that has become final' and 'order that has become final' mean a cease and desist order, or an order, issued by the Farm Credit Administration with the consent of the System institution or the director or officer or other person concerned, or with respect to which no petition for review of the action of the Farm Credit Administration has been filed and perfected in a court of appeals as specified in section 5.30(b) of this Act, or with respect to which the action of the court in which the petition is so filed is not subject to further review by the Supreme Court of the United States in proceedings provided for in section 5.30(b), or an order issued under section 5.29(a) or (b) of this Act;

"(b) the term 'violate' means to act (alone or with one or more persons) for or toward causing, bringing about, participating in, counseling, or aiding or abetting a violation;

"(c) the term 'violation' includes without limitation any action (alone or with one or more persons) for or toward causing, bringing about, participating in, counseling, or aiding or abetting a violation;

"(d) the term 'System institution' includes the institutions enumerated in section 1.2 of this Act, service organizations chartered under part D of title IV of this Act, and the

Farm Credit System Capital Corporation chartered under part D1 of title IV of this Act; and

"(e) the term 'unsafe or unsound practice' shall be defined by the Farm Credit Administration by rule, regulation, or order.

"SEC. 5.35. NOTICE OF SERVICE.—Any service required or authorized to be made by the Farm Credit Administration under this part may be made by registered mail, or in such other manner reasonably calculated to give actual notice as the Farm Credit Administration may, by regulation or otherwise, provide. Copies of any notice or order served by the Farm Credit Administration on any association or any director or officer thereof or other person participating in the conduct of its affairs, under the provisions of this part, shall also be sent to the supervisory bank.

"SEC. 5.36. ANCILLARY PROVISIONS; SUBPOENA POWER.—In the course of, or in connection with, any proceeding under this part, the Farm Credit Administration, or any designated representative thereof, including any person designated to conduct any hearing under this part, shall have the power to administer oaths and affirmations, to take or cause to be taken depositions, and to issue, revoke, quash, or modify subpoenas and subpoenas duces tecum. The Farm Credit Administration shall make rules and regulations with respect to any such proceedings, claims, examinations, or investigations. The attendance of witnesses and the production of documents provided for in this section may be required from any place in any State or territory or other place subject to the jurisdiction of the United States at any designated place where such proceeding is being conducted. The Farm Credit Administration or any party to proceedings under this part may apply to the United States District Court for the District of Columbia, or the United States district court for the district in which such proceeding is being conducted, or where the witness resides or carries on business, for enforcement of any subpoena or subpoena duces tecum issued under this section and such courts shall have jurisdiction and power to order and require compliance therewith. Witnesses subpoenaed under this section shall be paid the same fees and mileage that are paid witnesses in the district courts of the United States. Any court having jurisdiction of any proceeding instituted under this part by any System institution or other person, may allow to any such institution or person such reasonable expenses and attorneys' fees as it deems just and proper; and such expenses and fees shall be paid by the institution or from its assets. Any person who willfully fails or refuses to attend and testify or to answer any lawful inquiry or to produce books, papers, correspondence, memoranda, contracts, agreements, or other records if in such person's power so to do, in obedience to the subpoena of the Farm

Credit Administration, shall be guilty of a misdemeanor and, on conviction, shall be subject to a fine of not more than $1,000, or to imprisonment for a term of not more than one year, or both.".

TECHNICAL AND CONFORMING AMENDMENTS

SEC. 205. (a)(1) Title V of the Farm Credit Act of 1971 is further amended by inserting after section 5.36, as added by section 204, the following heading:

"PART D—MISCELLANEOUS".

(2) Sections, 5.26, 5.27, 5.28, 5.29, and 5.30 of the Farm Credit Act of 1971 are redesignated as sections 5.40, 5.41, 5.42, 5.43, and 5.44, respectively.

(b) Section 2.15 of the Farm Credit Act of 1971 is amended by—

(1) in the first sentence of subsection (a)—

(A) striking out "rules and regulations" and inserting in lieu thereof "standards"; and

(B) striking out "and approved by the Farm Credit Administration";

(2) in the first sentence of subsection (b)—

(A) striking out "regulations" and inserting in lieu thereof "standards"; and

(B) striking out "with the approval of the Farm Credit Administration as provided in" and inserting in lieu thereof "subject to the provisions of"; and

(3) in the last sentence of subsection (b)—

(A) striking out "regulations" and inserting in lieu thereof "standards"; and

(B) striking out "or of Farm Credit Administration".

(c) Title I of the Farm Credit Act of 1971 is amended by—

(1) in section 1.4—

(A) striking out "the supervision of" in the matter preceding paragraph (1) and inserting in lieu thereof "regulation by";

(B) in paragraph (17), striking out "vested in or delegated to the bank";

(C) striking out paragraph (19); and

(D) redesignating paragraphs (20), (21), (22), and (23) as paragraphs (19), (20, (21), and (22), respectively;

(2) in section 1.5(d), striking out "to the Governor of";

(3) in section 1.5(e), striking out "the Governor of" in the first sentence;

(4) in section 1.13—

(A) striking out "GOVERNOR" in the section heading and inserting in lieu thereof "FARM CREDIT ADMINISTRATION";

(B) striking out "the Governor of" in the seventh sentence;

(C) striking out "Governor" each place that word appears in the eighth, ninth, and tenth sentences and inserting in lieu thereof "Farm Credit Administration"; and

(D) striking out "him" and "he" in the tenth sentence and inserting in lieu thereof, in both instances, "Farm Credit Administration";

(5) in section 1.15—

(A) inserting "the regulation" before "of the Farm Credit Administration" in the matter preceding paragraph (1); and

(B) striking out "or delegated to" in paragraph (12);

(6) in section 1.17(b)—

(A) striking out paragraph (2); and

(B) redesignating paragraph (2) as paragraph (3); and

(7) in section 1.20, striking out "the Governor of".

(d) Title II of the Farm Credit Act of 1971 is amended by—

(1) in section 2.1—

(A) striking out "the supervision of" in the matter preceding paragraph (1) and inserting in lieu thereof "regulation";

(B) striking out "vested in or delegated to the intermediate credit bank" in paragraph (14); and

(C) striking paragraph (21);

(2) in the first sentence of section 2.2(d), striking out "the Governor of";

(3) in section 2.2(f)—

(A) striking out "the Governor of" and "other than the tax imposed by section 4.0(c)" in the first sentence; and

(B) striking out "the Governor of" in the second sentence;

(4) in section 2.2(g), striking out "the Governor of" in the ninth sentence;

(5) in section 2.2(h), striking out "Governor" and inserting in lieu thereof "Farm Credit Administration";

(6) in the first sentence of section 2.3(c)—

(A) striking out "(a)(1) and (2)" and inserting in lieu thereof "(a)(2)"; and

(B) striking out "(in the case of financing institution under subsection (a)(2) of this section)";

(7) in the first sentence of section 2.6(a)—

(A) striking out "the Governor of";

(B) striking out paragraph (4); and

(C) redesignating paragraphs (5), (6), and (7) as paragraphs (4), (5), and (6), respectively;

(8) in the first sentence of section 2.6(b), striking out "the Governor of";

(9) in section 2.6(c)—

(A) striking out "the Governor of" in the first sentence; and

(B) striking out the third sentence;

(10) in the first sentence of section 2.7, striking out "the Governor of";

(11) in section 2.10—

(A) striking out "the Governor of" in the sixth sentence;

(B) striking out "Governor" in the seventh sentence and inserting in lieu thereof "Farm Credit Administration";

(C) striking out "Governor" in the eighth sentence and inserting in lieu thereof "Farm Credit Administration"; and

(D) in the ninth sentence—

(i) striking out "Governor" and inserting in lieu thereof "Farm Credit Administration"; and

(ii) striking out "him" and "he" and inserting in lieu thereof in both places "Farm Credit Administration";

(12) in section 2.12—

(A) in the matter preceding paragraph (1), inserting "regulation by" before "the Farm Credit Administration"; and

(B) striking out "or the Farm Credit Administration" in paragraph (19);

(13) in section 2.13(c), striking out "the Governor of";

(14) in section 2.13(d), striking out "Governor" both places that word appears and inserting in lieu thereof "Farm Credit Administration";

(15) in section 2.13(j), striking out "Governor" and inserting in lieu thereof "Farm Credit Administration"; and

(16) in section 2.14(b), striking out "Governor" and inserting in lieu thereof "Farm Credit Administration".

(e) Title III of the Farm Credit Act of 1971 is amended by—

(1) in section 3.1—

(A) in the matter preceding paragraph (1), striking out "supervision" and inserting in lieu thereof "regulation";

(B) in paragraph (13)(A), inserting "under regulations issued" after "authorized";

(C) striking out paragraph (16); and

(D) redesignating paragraphs (17), (18), and (19) as paragraphs (16), (17), and (18), respectively;

(2) in section 3.2(a), striking out "Governor with the advice and consent of the Federal Farm Credit Board"; and inserting in lieu thereof "Farm Credit Administration";

(3) in section 3.3(d), inserting "under regulations issued by" after "authorized";

(4) in section 3.3(e), striking out "Governor" and inserting in lieu thereof "Farm Credit Administration";

(5) in section 3.4, striking out "the Governor of";

(6) in section 3.5—

(A) striking out "the Governor" and "to the extent required by section 4.0(b) of this Act" in the first sentence; and

(B) in the third sentence, striking out "When the requirements of section 4.0(b) have been met, voting" inserting in lieu thereof "Voting";

(7) in the first sentence of section 3.11(a)—

(A) striking out "the Governor of";

(B) striking out paragraph (3); and

(C) redesignating paragraphs (4), (5), and (6) as paragraphs (3), (4), and (5), respectively;

(8) in section 3.11(b)—

(A) striking out "the Governor of" in the first sentence; and

(B) striking out the third sentence;

(9) in section 3.12, striking out "the Governor of" both places that phrase appears in the first sentence; and

(10) in section 3.13, striking out "the Governor of" in the second sentence.

(f) Title IV of the Farm Credit Act of 1971 is further amended by—

(1) in section 4.2—

(A) in the matter preceding subsection (a), striking out "supervision of" and inserting in lieu thereof "regulation by";

(B) in subsection (b)—

(i) striking out "4.3(b)" and inserting in lieu thereof "4.3(c)"; and

(ii) striking out "the Governor" and inserting in lieu thereof "the Farm Credit Administration";

(C) in subsection (c), striking out "the Governor" and inserting in lieu thereof "the Farm Credit Administration"; and

(D) in subsection (d)—

(i) striking out "the Governor" in the first sentence and inserting in lieu thereof "the Farm Credit Administration"; and

(ii) in the second sentence, striking out "the Governor" both places that phrase appears and inserting in lieu thereof "the Farm Credit Administration";

(2) in section 4.4(b)—

(A) striking out "the Governor to execute" in the first sentence and inserting in lieu thereof "the execution of"; and

(B) striking out "by the Governor" in the second sentence;

(3) in section 4.5, striking out "the Governor" in the fourth sentence and inserting in lieu thereof "the Farm Credit Administration";

(4) in section 4.11, striking out "the Governor with the advice and consent of the Federal Farm

Credit Board" and inserting in lieu thereof "the Farm Credit Administration";

(5) in section 4.12(a), striking out "Federal Farm Credit Board" in the third sentence and inserting in lieu thereof "Farm Credit Administration";

(6) in the first sentence of section 4.17, inserting ", as provided in section 5.17(a)(5) of this Act," after "with the approval of";

(7) in section 4.18, inserting "under regulations issued by" before "the Farm Credit Administration";

(8) in section 4.25—

(A) striking out "the Governor of" in the second sentence;

(B) striking out "Governor" in the third sentence and inserting in lieu thereof "Farm Credit Administration"; and

(C) striking out "Governor" in the fourth sentence and inserting in lieu thereof "Farm Credit Administration";

(9) in section 4.26—

(A) striking out "GOVERNOR" in the section heading and inserting in lieu thereof "FARM CREDIT ADMINISTRATION";

(B) striking out "Governor" wherever that word appears in the text and inserting in lieu thereof "Farm Credit Administration";

(C) striking out "he" in the first sentence and inserting in lieu thereof "Farm Credit Administration"; and

(10) in section 4.27, striking out "supervision" and inserting in lieu thereof "regulation".

(g) Title V of the Farm Credit Act of 1971 is further amended by—

(1) in section 5.0—

(A) striking out "Federal Farm Credit Board" in the first and second sentences and inserting in lieu thereof "Farm Credit Administration"; and

(B) striking out "5.18(2)" in the third sentence and inserting in lieu thereof "5.17(2)";

(2) in section 5.1(a), striking out "Federal Farm Credit Board" and inserting in lieu thereof "Farm Credit Administration Board";

(3) in section 5.2(a), striking out "Governor with the advice and consent of the Federal Farm Credit Board" and inserting in lieu thereof "Farm Credit Administration Board";

(4) in section 5.2(d), striking out "sections 5.1 and 5.2" and inserting in lieu thereof "section 5.1 and this section";

(5) in section 5.6(a), striking out "supervision of" in paragraph (5) and inserting in lieu thereof "regulation by"; and

(6) in section 5.15(b), as so redesignated by section 201(5)—

(A) striking out "said Administration" both places that phrase appears in the first sentence and inserting in lieu thereof "the Farm Credit Administration"; and

(B) striking out "the Administration" and "such Administration" in the second sentence and inserting in lieu thereof "the Farm Credit Administration".

TITLE III—PROTECTION FOR FARMERS AND OTHER FARM CREDIT SYSTEM BORROWERS

DISCLOSURE AND ACCESS TO INFORMATION

SEC. 301. (a) Section 4.13 of the Farm Credit Act of 1971 is redesignated as section 4.13B.

(b) The Farm Credit Act of 1971 is amended by inserting before section 4.13B, as so redesignated by subsection (a), the following:

"SEC. 4.13. DISCLOSURE.—(a) The Farm Credit Administration shall promulgate regulations requiring System lending institutions to provide to their borrowers, for all loans that are not subject to the Federal Truth in Lending Act, meaningful and timely disclosure of the following:

"(1) the current rate of interest on the loan;

"(2) in the case of an adjustable or variable rate loan, the amount and frequency by which the interest rate can be increased during the term of the loan or, if there are no such limitations, a statement to that effect, and the factors (including, but not limited to, the cost of funds, operating expenses, provision for loan losses, and the likelihood of financial assistance to or from other institutions in the System) that will be taken into account by the lending institution in determining adjustments to the interest rate;

"(3) the effect, as shown by a representative example or examples, of the required purchase of stock or participation certificates in the institution on the effective rate of interest; and

"(4) any change in the interest rate applicable to the borrower's loan.

"(b) The Farm Credit Administration shall promulgate regulations setting forth guidelines to be followed by System lending institutions in developing a policy governing forbearance. Each System lending institution shall provide borrowers with a copy of the institution's policy regarding forbearance at such time or times as the Farm Credit Administration shall prescribe in such regulations.

"SEC. 4.13A. ACCESS TO DOCUMENTS AND INFORMATION.—The Farm Credit Administration shall promulgate regulations requiring banks and associations of the Farm Credit System to provide their borrowers, at the time of execution of loans, copies of all documents signed by the borrower and at any time thereafter, on a borrower's request, copies of all documents signed or delivered by the borrower. The regulations also shall require such banks and associations to provide their stockholders, on request, a copy of the institution's articles of incorporation or charter and bylaws.".

NOTICE ON APPLICATIONS

SEC. 302. Section 4.13B of the Farm Credit Act of 1971, as so redesignated by section 301(a), is amended by (1) inserting "written" before "notice" and (2) inserting, before the period at the end thereof, the following: ", and of the applicant's right to review under section 4.14".

RECONSIDERATION

SEC. 303. Section 4.14 of the Farm Credit Act of 1971 is amended to read as follows:

"SEC. 4.14. RECONSIDERATION OF ACTION ON LOAN APPLICATION.—The Farm Credit Administration shall promulgate regulations requiring the board of directors of each

Farm Credit System lending institution to establish a credit review committee. Any loan applicant who has received written notice, under section 4.13, of a decision to deny or reduce the loan applied for, if the applicant so requests in writing within thirty days after receiving such notice, may obtain a review of such decision in person before the credit review committee. Promptly after any such review, the applicant shall be notifed in writing of the credit review committee's decision and the reasons therefor.".

NOTICE WITH RESPECT TO STOCKHOLDERS ON LOAN DEFAULT

SEC. 304. (a) The sixth sentence of section 1.16(a) of the Farm Credit Act of 1971 is amended by inserting, before the period at the end thereof, the following: "and on written notice to the stockholder".

(b) Section 2.13(k) of the Farm Credit Act of 1971 is amended by inserting, before the period at the end thereof, the following: ", on written notice to the borrower and approval by the bank of such retirement".

MINIMIZING THE ADVERSE EFFECT ON BORROWERS OF SYSTEM INSTITUTION INSOLVENCY

SEC. 305. (a) Section 4.12(a) of the Farm Credit Act of 1971 is amended by inserting, immediately after the first sentence, the following: "In the case of a liquidation of an association, such regulations, among other things, shall direct the supervising bank to institute such measures as it deems appropriate to minimize the adverse effect of the liquidation on those borrowers whose loans are purchased by or otherwise transferred to another System institution.".

(b) Section 4.12(b) of the Farm Credit Act of 1971 is amended by inserting after subsection (b), as added by section 202, the following: "(c) In the case of an insolvency of an association, regulations of the Farm Credit Administration regarding insolvency, among other things, shall direct the supervising bank to institute such measures as it deems appropriate to minimize the adverse effect of the insolvency on those borrowers whose loans are purchased by or otherwise transferred to another System institution.".

TITLE IV—IMPLEMENTATION PROCEDURES

EFFECTIVE DATE

SEC. 401. The provisions of titles I through III of this Act shall become effective thirty days after enactment.

INTERIM IMPLEMENTATION

SEC. 402. (a) Until the Chairman of the Farm Credit Administration Board provided for under section 201(1) of this Act is appointed by the President and confirmed by the Senate, the Governor of the Farm Credit Administration, under the Farm Credit Act of 1971 as in effect on the date of enactment of this Act, shall perform the functions of the Chairman prescribed for the Chairman by this Act.

(b) Until at least three members of the Farm Credit Administration Board provided under section 201(1) of this Act are appointed by the President and confirmed by the Senate, the Governor of the Farm Credit Administration, under the Farm Credit Act of 1971 as in effect on the date of enactment of this Act, shall perform the functions of the Farm Credit Administration Board prescribed for such Board by this Act: *Provided*, That when the Chairman of such Board is so appointed and confirmed, the Chairman shall assume any responsibilities and powers of the Board being exercised by the Governor under this subsection.

SENSE OF CONGRESS

SEC. 403. It is the sense of Congress that the pressing needs of the Farm Credit System and the United States agricultural industry require the implementation of this Act as soon as practicable, and that the President should ensure that the members of the Farm Credit Administration Board constituted under section 201(1) are appointed not later than thirty days after enactment of this Act.

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THE SECRETARY OF THE TREASURY
WASHINGTON

November 19, 1985

Dear Kika:

I understand that your staff is in the process of drafting a bill to restructure the Farm Credit Administration into a true regulator and to create authority for the Farm Credit System Capital Corporation to mobilize fully the FCS's earned surplus to absorb operating losses and manage troubled loan assets.

The Administration supports this effort wholeheartedly. We believe that prompt enactment of these reforms will help the FCS remain a viable lender for America's farmers and reassure concerned capital market investors.

Unfortunately, I understand that your bill may also contain some form of financial assistance or "backstop" for the FCS. I fear that this is the wrong action, at the wrong time, and could lead to the wrong result for all of us.

As of September 30, 1985, the FCS had earned surplus of $5.5 billion, loan loss reserves of $1.6 billion, and member stock totaling $5.3 billion. With that capital base, the System does not now need our financial support. However, the System does need immediate remedial legislative action to ensure it has the tools to help itself and reassure investors.

The President has decided that the Administration would further assess the FCS's need for Federal financial assistance, but only if the Congress is willing to legislate the restructuring and self-help changes we all want to achieve. The Administration is committed to a reassessment of the financial assistance question once the necessary reforms have been implemented.

I am also concerned that the inclusion of financial assistance language would require the proper additional review by other committees and would certainly slow down the legislative process at a time when the farmers, the investors, and the Government need prompt action. Furthermore, a bill that incorporates financial assistance will necessarily involve longer consideration by the Senate.

It is crucial that legislation be enacted this year to reform the FCA and to enable the FCS to muster its own considerable resources to help farmer borrowers. We will work with you to enact this legislation. However, the inclusion of financial assistance provisions would make it virtually impossible to enact this legislation this year. I look forward to working with you and your Committee to resolve these important issues.

I am also sending this letter to Congressmen Coleman, Jones and Madigan.

Sincerely,

Jim

James A. Baker, III

The Honorable E. (Kika) de la Garza
Chairman
Committee on Agriculture
House of Representatives
Washington, DC 20515

Farm Credit Administration

1501 Farm Credit Drive
McLean, Virginia 22102-5090
(703) 883-4000

November 29, 1985

Honorable E (Kika) de la Garza
Chairman, Committee on Agriculture
House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

With this letter we are conveying to you our analysis and recommendations for technical and substantive revisions to H.R. 3792.

We have three major concerns. First, the independence of the Capital Corporation must be strengthened to ensure effective self-help. Second, the standards governing System assistance to its member institutions must be strengthened to minimize the need for Federal funds. Third, the proposed five-member, full-time Farm Credit Administration Board should be reduced to three to avoid operational difficulties.

The functions of the Capital Corporation cannot be adequately fulfilled absent strong, independent, outside direction. The System has demonstrated its inability to overcome parochial concerns and marshal its resources to bring them to bear to solve its problems. While the Capital Corporation is clearly part of the System, it is a mechanism to achieve effective use of System resources which is essentially a quasi-governmental function for which FCA is ultimately accountable.

Therefore, we urge that Section 4.28C, page 7, lines 20 through 24 be amended to read, "Two of such members shall be appointed from among the stockholders, officers, board members of System institutions and three of such members shall be individuals representing the public interest..."

The standards governing assessment of System institutions and assistance to System institutions must be sufficient to ensure the maximum utilization of System resources and to minimize the need for Federal funds. Significant pressures are already being exerted to limit the ability of the Agency and the Capital Corporation to effectively utilize System resources.

Therefore, we urge that Section 4.28H (14)(A) and (B) on page 12 and (15) on page 13 be deleted and the provisions of S. 1884, Section 433B (a) and (b) on page 53 and 54 be adopted with the following modification: On page 53 line.23 strike everything after "point" and insert in lieu thereof, "where its continued existence or ability to obtain adequate funding is jeopardized," and on page 53, line 15, and page 54 line 1, insert after the word "shall," the words "be authorized to."

Establishing a five member, full-time Board for the Farm Credit Administration will weaken the Chairman's ability to administer the Agency and will result in further operational difficulties. We therefore urge that Section 5.8 on page 20, line 15, be amended by striking the word "five" and insert in lieu thereof, "three" and that further amendments to the Section be made as necessary to conform to this change.

These changes as well as further technical and substantive concerns are outlined in the attached report on H.R. 3792.

Absent effective resolution of these problems Congress faces the very real prospect of revisiting the issue of System financial assistance in 1986.

We look forward to continuing to work with you on this matter.

Sincerely,

Donald E Wilkinson

Donald E. Wilkinson
Governor

H.R. 3792

Farm Credit Act Amendments of 1985

Farm Credit Administration Comments

The following is a list and brief explanation of the substantive comments of the Farm Credit Administration (FCA) on H.R. 3792.

1. Section 102 contains amendments to section 4.12 of the Farm Credit Act (Act) of 1971, as amended. The FCA recommends that the bill include a provision contained in section 2 of the proposed legislation relating to districtwide mergers. The FCA proposal would allow all associations in a district to merge upon the affirmative vote of the stockholders of each of two-thirds of the associations or the affirmative vote of three-fourths of the voting stockholders in the district on an aggregate basis. This change would facilitate such mergers when it was clear that a significant majority of the total association stockholders favored the merger.

2. Section 103 would establish the Farm Credit System Capital Corporation (Capital Corporation). New Section 4.28C provides that the board of directors of the Capital Corporation shall consist of three members appointed from among members of district boards and two members who represent the public interest. The FCA recommends that two members of the board should be appointed from among persons who are stockholders, officers, or directors of Farm Credit System (System) institutions and that three members should be individuals representing the public interest.

We believe these changes are necessary to ensure that the Capital Corporation will effectively carry out the congressional mandate embodied in this legislation. It is essential for the System to use all its available resources on an equitable basis prior to seeking assistance from the Federal Government. There are many difficult decisions that have to be made in that regard, and we do not believe that a Capital Corporation controlled by the System will be well positioned to discharge that responsibility. We believe that failure to make the changes could cause the Capital Corporation to be indecisive in its decisions regarding assessments and possibly seek Federal assistance prior to the time that it is warranted. Furthermore, the Capital Corporation will be exercising an important, essentially governmental function of determining which institutions receive financial assistance and the types and amounts of such assistance. The Capital Corporation's determinations regarding the provision of financial assistance will dictate the necessity for the FCA to place institutions into receivership. It is imperative that the chairman of the FCA board be able to exercise discretion regarding placing institutions into receivership, rather than being required to act on the basis of Capital Corporation decisions over which the chairman had no direct control.

3. New Section 4.28H(14) and (15) establishes the criteria under which the Capital Corporation can assess System institutions and provide financial assistance to other institutions. We recommend that the sections be substituted with comparable provisions contained in Section 4.33B (a) and (b) of S. 1884 with minor amendments.

The language currently contained in the House Bill would require that all existing System institutions, regardless of their financial viability and the efficiency of their operation, should be provided with financial assistance to ensure their solvency. This requirement would require that many System institutions whose inefficiency and lack of competitiveness makes them structurally nonviable would be nevertheless eligible to consume resources from other System institutions until such resources were completely used up. We believe the proper focus of this section should be the assurance that borrowers in the territories involved receive System services, not that any specific institution be preserved to provide that service. In addition, the existing language contains severe restrictions on the ability of the Capital Corporation to assess other System institutions and, if implemented, could require the use of Federal financial assistance long before it was actually needed.

4. Section 4.28H (a)(20) provides the authority under which the Capital Corporation can restructure loans. We are very concerned that this provision will cause the Capital Corporation to become a lender of last resort that will be constantly embroiled in litigation, to the ultimate jeopardy of the System institutions that are financing its operations. We therefore recommend that this provision be amended to substitute the language contained in Section 4.34 (b) of S. 1884. In the alternative, we recommend that the existing language in the House bill be amended by the addition of the following provision: "The Capital Corporation shall not be authorized to compromise indebtedness or enter into loan-servicing arrangements under circumstances where.

the Capital Corporation determines that such compromise or restructuring would cause the Capital Corporation to be repaid an amount less than the amount the Capital Corporation can recover from available sources of repayment."

5. Section 4.28K provides the backstop line of credit through the Treasury. We recommend that this provision be amended to delete the standards contained on page 17, line 6 through 14, which establish criteria contained in the FCA certification. In place of that language, the bill should include a reference to the appropriate provisions contained in Section 4.28H that establish the basis upon which assessments can be made and financial assistance be provided to System institutions. This change will ensure that the bill contains only one set of standards to be used both in terms of making assessments and providing financial assistance and in certifying the need for Federal financial assistance to the Secretary of the Treasury.

6. New Section 5.7 contains the provisions relating to the new FCA board. If it is determined that a full-time board is the appropriate structure, we recommend that the board be composed of three rather than five members. While there are benefits associated with a larger board, on balance we believe that given the size of the agency it would be most efficient to restrict the size of the board along the lines of other agencies, such as the FDIC and FSLIC.

7. New Sections 5.10 (c) and 5.17 (a)(13) provide independent litigation authority of the FCA. A similar provision was contained in the FCA

bill, the Treasury bill, and S. 1884. We recommend that the language contained in these two sections be substituted with the language contained in Section 112(9) of S. 1884 in order to avoid the possible unintended effects of this language, which may raise questions about the status of the FCA as a Federal agency and the role of the FCA in litigation involving System institutions in receivership.

8. New Section 5.12 provides for the discretionary establishment of an advisory committee composed of members of the Federal Farm Credit Board (Board). We believe the provision should be amended to provide that the Board shall exist for a period of 1 year following the date of enactment of the Act. This will ensure that during the transition period, the new FCA board will have the ongoing opportunity to solicit and obtain the advice and recommendations of current members of the Board. It will also ensure that such recommendations come from Board members elected from all 12 districts, even though the term of one or more such members may expire in the interim.

9. Section 201(7) contains amendments to redesignated Section 5.17 of the Act, which establishes the powers, functions, and responsibilities of the FCA. New Section 5.17 (a)(2) would require that consolidations of System boards and management agreements would require a majority vote of the stockholders of the institutions involved. We believe that this change from existing law should be deleted. To date, all but one of the 12 Farm Credit districts have approved some form of partial or total joint management. To the extent this change is enacted, it may question the existing operational structures of those districts.

Furthermore, decisions regarding consolidations and determinations regarding management agreements are, in the normal corporate context, board decisions that do not require stockholder votes. We believe that subjecting such matters to stockholder votes unduly and unnecessarily impinge upon the normal discretion of the boards of directors. To the extent the stockholders are not happy with the decisions of their boards of directors they always have the opportunity to replace such directors during the normal election process.

10 . Section 203 (a) contains revisions to Section 5.19 of the Act, which provide for the examination of System institutions. We support the changes contained in this section, but believe that the requirement for a yearly examination of each System institution should be deleted. Consistent with the activities of other financial institution regulatory agencies, the FCA examination function should be focused on those institutions that are in the greatest need of examination. The requirement for a yearly examination of each institution diverts limited examination resources away from those institutions where it should be concentrated. The frequency of examination should depend on the nature of the institution, its history of problems, and the nature and extent of changing circumstances affecting that institution.

11. New Section 5.19 (b) contains a provision strongly supported by the FCA, which requires System institutions to publish annual reports of conditions. However, the FCA believes that the agency should be able to except institutions from this annual reporting requirement, based on the determination that the report of an institution that is

consolidated with one or more other institutions is sufficient. This change will principally affect the Federal land bank associations, which are not primary lenders but rather agents of the land banks, and because their loan portfolios and the risk contained therein are reflected in the report of the Federal land bank in the district, separate reporting may not be required.

12. Section 204 contains the new enforcement powers of the FCA. The FCA endorses the content and structure of provisions contained in this section but makes the following recommendations.

(a) New Section 5.26, which provides for the issuance of temporary cease-and-desist orders, should be amended to eliminate the requirement for showing a substantial dissipation of assets or earnings of the institution or activities likely to seriously weaken the financial institution. We believe the references to "substantial" and "seriously" should be deleted in order to give FCA the maximum flexibility, within the context of the issuance of temporary cease-and-desist orders, to preserve the status quo pending a hearing.

(b) New Section 5.32 authorizes the imposition of civil money penalties for persons or institutions who violate the provisions of the Act or the terms of a cease-and-desist order. Because many of the specific standards of conduct that will be imposed on System institutions are not spelled out in the Act, but rather through the regulatory process, the FCA believes that this.

provision should be amended to include a reference to the violation of regulations issued under the Act.

(c) New Section 5.33 provides for the temporary appointment of suspended or removed directors. The FCA believes this provision should also include a similar provision relating to the temporary appointment of officers of System institutions who have been removed or suspended. We recommend the inclusion of the provision contained in Section 4.38 (b) of the FCA proposed legislation, which provides that when an officer has been removed pending an appeal to the removal decision or until a successor has been appointed, the FCA may appoint a temporary replacement. This provision would ensure that there would be no lapse in the management direction of the institution. Furthermore, this provision ensures that a subsequently appointed officer is approved by the FCA, thereby avoiding the possibility of a second removal action.

(d) The bill does not contain a provision contained in Section 4.42 of the FCA proposed legislation, which would provide that officers and directors would be personally liable for their actions that demonstrate gross negligence, breaches of fiduciary duties, or willful violations of the Act. Under the FCA proposal, such persons would be personally and individually liable for all damages that the institution, its stockholders, or any other person suffered in consequence thereof, and such liability could be enforced in the district courts of the United States. The FCA believes that the inclusion of this provision is essential to provide System institutions and their stockholders with a Federal private right of action against System directors and officers who engage in the type of conduct enumerated in this section. The FCA-proposed provision is substantially the same as the provisions applicable to other banking systems, such as those contained in 12 U.S.C. Section 93 and 12 U.S.C. Section 503.

13. Section 301 (b) enumerates certain shareholder rights. The FCA believes that the provisions of new Section 4.13 (a) and (b) and new Section 4.13A should be amended to delete the requirement for the FCA to issue implementing regulations. The FCA believes those provisions should establish statutory rights, and as drafted, there is no necessity for the FCA to issue regulations relating to those rights.

14. Section 303 contains a new section 4.14 of the Act regarding reconsideration of actions on loan applications. As discussed above, the FCA believes this section should not require the issuance of FCA regulations. In addition, in order to avoid the possibility of numerous lawsuits that could arise in connection with this provision, we believe a new sentence should be added that provides that the decisions of the review committee shall not be subject to judicial review. In the absence of such provision, we would anticipate that this provision would be used as a significant delaying tactic by litigants in foreclosure actions, and that the losses incurred as a result would cause substantial injury to the institutions and their shareholders.